Supreme Court, U.S.
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In The

Supreme Court of the United States

METRONET SERVICES CORPORATION,

Petitioner,

v.

QWEST CORPORATION,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Court's opinion in *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 124 S. Ct. 872, 157 L. Ed. 2d 823 (2004) (hereinafter referred to as "Verizon" opinion), impacts a traditional antitrust claim brought by a small competitive local exchange company where the claim has nothing to do with the duties imposed on incumbent local telephone companies by the Telecommunications Act of 1996, 47 U.S.C. § 151 *et seq.* ("1996 Act").

RULE 29.6 STATEMENT

MetroNet Services Corp. and MetroNet Telemanagement Corp. are now known collectively as MetroNet Services Corp. It is a Washington corporation which does not have any parent or subsidiary corporations. No other corporations own any interest in it nor does it own any interest in any other corporation.

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PETITION FOR WRIT OF CERTIORARI

Petitioner MetroNet petitions this Court for writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

On April 16, 2001, the District Court, in an unreported opinion, dismissed MetroNet's case on summary judgment. (Pet. App. 81a-97a.) The Ninth Circuit reversed the District Court's dismissal. *MetroNet Services Corp. v. US West Communications*, 325 F.3d 1086 (9th Cir. 2003). The Ninth Circuit withdrew that opinion and issued an amended opinion still reversing the District Court's dismissal. *MetroNet Services Corp. v. US West Communications*, 329 F.3d 986 (9th Cir. 2003), *vacated and remanded*, 540 U.S. 1147, 157 L. Ed. 2d 1040, 124 S. Ct. 1144 (2004) (hereinafter referred to as "MetroNet I"). (Pet. App. 28a-80a.) Respondent Qwest petitioned this Court for a writ of certiorari and this Court granted the petition, vacated the Ninth Circuit's opinion and remanded the case to the Ninth Circuit to consider the opinion of *Verizon*. *Id.*, 540 U.S. 1147. (Pet. App. 27a.) On September 24, 2004, the Ninth Circuit issued its opinion upholding the District Court's dismissal. *MetroNet Services Corp. v. Qwest Corp.*, 383 F.3d 1124 (9th Cir. 2004) (hereinafter referred to as "MetroNet II"). (Pet. App. 1a-25a.) On December 17, 2004, the Ninth Circuit filed its denial of MetroNet's petition for rehearing and/or *en banc* review. (Pet. App. 98a.)

JURISDICTION

The judgment of the Court of Appeals was entered on September 24, 2004. (Pet. App. 26a.) The Court filed its denial of the petition for rehearing and/or *en banc* review on December 17, 2004. (Pet. App. 98a.) This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 2 of the Sherman Act, 15 U.S.C. § 2 and provisions of the Communications Act of 1934, 47 U.S.C. § 151 *et seq.* 48 Stat. 1064 (1934), as amended by the Telecommunications Act of 1996, Pub. L. No. 104-104, 100 Stat. 56 (1996).

STATEMENT

Factual History

This case involves Qwest's[1] sale of local switched access service to small businesses. For many years, small businesses could only purchase flat rate exchange service (known as "1FB"). In the 1960s, Qwest introduced "Centrex" service. This product consisted of a telephone access line and calling features such as call forwarding, call waiting, and call hold. (Pet. App. 3a-4a.) Qwest bundled these two components together and sold them as one product.

[1] Qwest is also known as an incumbent local exchange company or "ILEC." MetroNet is sometimes referred to as a competitive local exchange company or "CLEC."

However, Qwest only intended to have Centrex sold to large businesses. (Pet. App. 4a.) It was meant to compete against private branch exchanges ("PBXs") sold by other competitors. *Id.* Large businesses, with 20 or more lines, were offered volume discounts. Small businesses, on the other hand, were forced to purchase Centrex without the discount or to purchase the more expensive 1FB service.

In 1985, MetroNet and others began to purchase and resell Centrex service to small businesses. MetroNet aggregated the lines belonging to a number of small businesses, thus enabling them to qualify for the volume discounts previously only available to large businesses. (Pet. App. 4a-5a.) Qwest priced Centrex based on the number of phone lines included in the Centrex package regardless of whether the lines were located in a single location. This was known as system pricing.

Public policy strongly favors resale. As the Washington Utilities and Transportation Commission ("WUTC") stated:

> Resale and rebilling are an essential adjunct of free access to, and the growth of competition in, telecommunications service. They bring appropriate market pressures to bear on the underlying provider of resold services, and allow aggregation, combination and coordination of services to supply smaller customers whose needs may be uneconomic for the original supplier to meet.

Fourth Supplemental Order, WUTC Docket No. UT-911488, *et al.* at 17-18 (1993). (Pet. App. 244a.) MetroNet was supplying Centrex services to small businesses because it was uneconomic for Qwest to do so. The Federal

Communications Commission ("FCC") has echoed these sentiments when it held:

> Resale . . . can benefit the public by assuring through the arbitrage mechanism that the resold and shared services are offered at rates closely related to cost.

In the Matter of Regulatory Policies Concerning Resale and Shared Use, Report and Order, 83 FCC 2d 167, 171 (1980). MetroNet's business promoted this public policy. It brought cheaper services to a segment of society, small businesses, that Qwest had chosen to ignore.

In 1987, the WUTC deregulated the features component of Centrex. The access line remained regulated. Qwest continued to bundle the unregulated features component together with the regulated access line despite repeated WUTC orders to unbundle them. (Pet. App. 99a-104a.)

As MetroNet and others began to sell more and more Centrex services to small businesses, Qwest became concerned. (Pet. App. 105a-107a.) Qwest feared losing revenue to MetroNet. *Id.* More and more small businesses were leaving Qwest's 1FB service and contracting with MetroNet. Qwest also became concerned because it was losing its direct contact with the captive small businesses. Qwest realized that as small businesses left and went to MetroNet, Qwest lost its ability to leverage off of the Centrex product and cross-sell other Qwest products. (Pet. App. 108a-113a.)

To stem this tide of lost revenue Qwest decided to change its pricing policy for Centrex from system pricing to per location pricing. In 1991, Qwest introduced Centrex Plus. Under this new product, in order to obtain the

volume discounts each customer needed to have 20 or more lines at each location, hence the name per location pricing.

The switch in pricing had no legitimate explanation nor cost justification. There are no greater economic efficiencies derived from this change in policy. *MetroNet I*, *supra* at 1008 (Pet. App. 63a.).[2] Qwest designed and implemented this change for one reason: to eliminate competition created by MetroNet and others. (Pet. App. 108a-113a.)[3]

On December 20, 1991, Qwest filed tariffs in Washington for Centrex Plus. (Pet. App. 118a-119a.) The WUTC decided to investigate. In the course of the investigation Qwest freely admitted that the purpose of the change in the pricing policy was to "destroy resellers." (Pet. App. 120a.)[4]

On December 30, 1994, the WUTC approved Qwest's tariff which included per location pricing.

On February 17, 1995, Qwest filed a request for a rate increase. (Pet. App. 121a-123a.) On April 11, 1996, the WUTC rejected Qwest's request for rate increases and ordered Qwest to abolish per location pricing for Centrex Plus. The WUTC stated:

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[2] MetroNet is citing to *MetroNet I*, for facts that are undisputed.

[3] At 117a, the author of the report wrote, concerning the purpose of introducing Centrex Plus: "Arbitrage of existing US West products will be limited if not eliminated."

[4] Pet. App. 120a is draft testimony by a US West representative. He is responding to a proposed question, "why are you trying to destroy resellers?"

> The Commission finds the existing arrangements are discriminatory and in practice they operate to benefit the Company. The Commission accepts Metronet's argument that it is high time for the Commission to order the Company to take the steps it encouraged the Company to take in the Centrex Plus compliance filing order.

Fifteenth Supplemental Order, WUTC Docket No. UT-950200 (1996). (Pet. App. 125a.) Qwest viewed the abolishment of per location pricing as "exasperating dramatically the existing revenue arbitrage situation" and appealed the WUTC's order. *MetroNet II* at 1128 (Pet. App. 6a.) The Washington Supreme Court upheld the Commission's order. *US West Communications, Inc. v. Washington Utilities and Transportation Commission*, 134 Wn.2d 74, 127, 949 P.2d 1337 (1997).

In December 1996, Qwest concluded:

> The current Washington tariff structure for Centrex Plus, [1FB], and features offers a profitable, relatively low risk opportunity for Centrex resellers to win significant market share of 1FB customers (mainly small business) in Washington. In essence, it appears that resellers can operate with positive margins while reselling [Centrex] at anywhere from 10 to 35 percent discounts to [1FB lines], not including features.

MetroNet II at 1128 (Pet. App. 6a.) To be clear, Qwest's primary concern with MetroNet was the fact that MetroNet was eroding Qwest's market share of 1FB customers, primarily small businesses. Qwest was losing an estimated $300,000 in revenues per month to MetroNet and other resellers. *MetroNet II* at 1128 (Pet. App. 6a.) Additionally, as stated earlier, for every small business

that Qwest lost to MetroNet it also lost its direct relationship and thus its ability to cross-sell. *Id.*

Accordingly, Qwest set about trying to stop the loss of its market share. On April 18, 1997, Qwest filed a price list with the WUTC reinstating per location pricing for features. (Pet. App. 127a-130a.) Qwest was able to circumvent the WUTC's regulatory oversight with respect to the features component because features had been classified as "competitive" back in 1997. *Fourth Supplemental Order*, WUTC Docket No. U-86-34, *et al.* (1987). (Pet. App. 131a-161a.) Therefore, despite the fact that but one year earlier the WUTC had concluded that per location pricing was "discriminatory" (Pet. App. 125a) Qwest was able to circumvent all regulatory supervision by simply filing a piece of paper.

Procedural History

On January 5, 2000, MetroNet filed an action against Qwest claiming it had violated 15 U.S.C. § 2. On April 16, 2001, the District Court granted Qwest's motion for summary judgment of dismissal. MetroNet appealed and on March 31, 2003, the Ninth Circuit reversed the District Court's order of dismissal as to MetroNet's antitrust claim. The Ninth Circuit amended its opinion on May 21, 2003. *See MetroNet I.* (Pet. App. 28a-80a.) Qwest petitioned this Court for a writ of certiorari. This Court granted Qwest's petition, vacated the Ninth Circuit's opinion and remanded the matter to the Ninth Circuit for consideration of the *Verizon* case. *Qwest Corp.*, 540 U.S. 1147. (Pet. App. 27a.) On remand, the Ninth Circuit affirmed the District Court's summary judgment of dismissal. *MetroNet II* at 1126. (Pet. App. 3a.)

ARGUMENT

This Court should grant MetroNet's petition for a writ of certiorari because the Ninth Circuit's opinion improperly extends the *Verizon* opinion to MetroNet's case. MetroNet's antitrust case does not implicate the Court's reasoning in *Verizon*. By improperly broadening the *Verizon* holding and applying it to standard antitrust claims, like MetroNet's, the Ninth Circuit has substantially narrowed antitrust law. *Verizon* did not immunize incumbent local exchange companies, like Qwest, from antitrust liability. Yet, if the Ninth Circuit's opinion stands, small companies that compete with incumbents, like Qwest, will be unable to bring antitrust claims.

An analysis of the court's opinion in *Verizon* shows how different it is from MetroNet's claim. In *Verizon*, a local telephone customer of AT&T filed a class action complaint against Verizon alleging that Verizon, as the incumbent local exchange company, had filled orders for service on a discriminatory basis, thus impeding the competitive local exchange company's ability to enter and compete in the market for local telephone service. *Verizon*, 157 L. Ed. 2d at 834. The district court dismissed the complaint and the Court of Appeals for the Second Circuit reversed.

The Court framed the fundamental issue in *Verizon* as:

> . . . [w]hether a complaint alleging breach of the incumbent's duty under the 1996 Act to share its network with competitors states a claim under § 2 of the Sherman Act. . . .

Verizon, 157 L. Ed. 2d at 832. In stark contrast to the *Verizon* claims, MetroNet alleges no breach of any provision

of the 1996 Act. MetroNet does not allege Qwest failed to share its network. Nor does MetroNet claim that Qwest breached any provision of the 1996 Act.

As the fact section plainly points out, Qwest first began to change its Centrex Plus pricing policy from system to per location pricing *in 1991*. This predates the 1996 Act by five years. Qwest's decision to change its pricing policy for Centrex Plus has *nothing* to do with its duties under the 1996 Act. The pricing change concerned the retail price for Centrex Plus.

MetroNet's decision to frame its complaint without alleging any violations of the 1996 Act was not artful drafting. The gravamen of MetroNet's complaint predates the 1996 Act and has nothing to do with the duties placed on incumbent local exchange companies as a result of the 1996 Act.

The gravamen of MetroNet's claim is that a monopolist, Qwest, made a voluntary change in its behavior in order to crush competition that had begun to erode its revenues and market share. This is a standard antitrust claim that is left entirely intact by the *Verizon* decision.

The *Verizon* Court held:

> To decide this case, we must first determine what effect (if any) the 1996 Act has upon the application of traditional antitrust principles.

Verizon, 157 L. Ed. 2d at 835. The entire premise and holding of *Verizon* does not impact MetroNet. *Verizon* concerned whether the 1996 Act enlarged § 2 of the Sherman Act. MetroNet's claim has nothing to do with enlarging § 2 case law. MetroNet's claim seeks to apply "traditional antitrust principles."

The Ninth Circuit held:

> . . . Qwest's change in pricing in order to eliminate arbitrage does not amount to exclusionary conduct under the Supreme Court's refusal to deal precedents as interpreted by *Verizon*.

MetroNet II at 1126. (Pet. App. 3a.) What the Ninth Circuit did is overlay the *Verizon* holding onto MetroNet's case. This is error. Forcing MetroNet's case, which has nothing to do with the 1996 Act, to fit into a case where the paramount issue is whether a violation of the 1996 Act states a claim under § 2 of the Sherman Act, is wrong. It greatly expands the scope and holding of *Verizon* and erodes, rather than upholds, traditional antitrust principles.

The *Verizon* court expressly made this finding. The Court held:

> But just as the 1996 Act preserves claims that satisfy existing antitrust standards, it does not create new claims that go beyond existing antitrust standards.

Verizon, 157 L. Ed. 2d at 835. The Ninth Circuit held that MetroNet sought to expand § 2 liability. *MetroNet II* at 1135 (Pet. App. 24a.) This is error. MetroNet seeks to apply existing refusal to deal principles.

The dispositive case, as recognized by the *Verizon* court, is *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 86 L. Ed. 2d 467, 105 S. Ct. 2847 (1985). This case involved ski resorts in Aspen, Colorado. The defendant owned three resorts and the plaintiff owned the fourth. For years, the plaintiff and defendant had voluntarily cooperated in the sale of tickets. Then, the

defendant cancelled the arrangement and refused to even sell tickets to the plaintiff at retail. *Id.* at 593-594. This Court upheld the jury verdict for the plaintiff, holding that the jury could have concluded that the defendant elected to forego short-run benefits in order to eliminate competition. As the *Verizon* held, the decision in *Aspen Skiing* "found significance in the defendant's decision to cease participation in a cooperative venture." *Verizon*, 157 L. Ed. 2d at 837. The same is true in MetroNet's case. Qwest was voluntarily selling Centrex Plus to MetroNet under a system pricing methodology. Suddenly, Qwest stopped "participating" and changed its methodology to one it knew would drive MetroNet out of business. The *Verizon* court held:

> The unilateral termination of a voluntary (*and thus presumably profitable*) course of dealing suggested a willingness to forsake short-term profits to achieve an anti-competitive end. *Ibid.* Similarly, the defendant's unwillingness to renew the ticket *even if compensated at retail price* revealed a distinctly anticompetitive bent.

Verizon, 157 L. Ed. 2d at 837 (Court's emphasis). The same behavior the *Verizon* court found important in *Aspen Skiing* exists in MetroNet's case. Qwest voluntarily entered into an arrangement whereby it was selling Centrex Plus to MetroNet under a system pricing methodology. There was no statutory compulsion, as in *Verizon*, forcing Qwest to sell Centrex Plus to MetroNet. Qwest subsequently terminated this voluntary course of dealing and replaced it with a decidedly anti-competitive methodology. Because the arrangement was voluntary, it is *presumably profitable*. *Id.* Qwest unilaterally terminated the arrangement, thus suggesting a "willingness to forsake short-term

profit to achieve an anti-competitive end." *Verizon*, 157 L. Ed. 2d at 837. In MetroNet's case, there is no need to presume an anti-competitive end. Qwest freely acknowledges that the switch from system to per location pricing was intended to eliminate competitors such as MetroNet. There was no cost justification. As the Ninth Circuit observed:

> Qwest has not asserted any procompetitive justification for per location pricing. It is undisputed that per location pricing has no cost-based justification.

MetroNet I at 1008. (Pet. App. 65a.) Qwest's conduct therefore falls squarely within the holding of *Aspen Skiing*.

In *Verizon*, because Verizon was compelled to enter into an arrangement, its "prior conduct sheds no light upon the motivation of its refusal to deal." *Verizon*, 157 L. Ed. 2d at 837. The opposite is true in MetroNet's case. Qwest's refusal to deal sheds substantial light because it was not compelled to enter into the arrangement with MetroNet in the first instance.

The Ninth Circuit looked at the same behavior and instead of drawing an inference in MetroNet's favor, did the opposite. The Ninth Circuit decided that Qwest's admitted termination of a profitable arrangement was an attempt "to increase short-term profits." *MetroNet II* at 1132. (Pet. App. 15a.) This is error. First, it turns rules applied at the summary judgment stage on their heads. Inferences must be viewed in a light most favorable to MetroNet. *Matsushita Electric Industrial Co. Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587, 89 L. Ed. 2d 538, 553, 106 S. Ct. 1348, 1357 (1986). The Ninth Circuit draws

inferences against MetroNet rather than in MetroNet's favor. Second, it ignores the abundance of evidence in the record as to why Qwest changed its behavior. As the Ninth Circuit observed, there was no cost justification to the change from system to per location pricing. *MetroNet I* at 1008. (Pet. App. 40a.) Qwest changed the pricing policy in order to destroy its competition. Qwest knew that changing from system to per location pricing would not add to its profits, but would rather destroy the competition that was eating into its revenues and market share.

The Ninth Circuit also found that Qwest's switch from system to per location pricing allowed it to continue to price discriminate. The Ninth Circuit reasoned that:

> . . . [b]y price discriminating through per location pricing, Qwest has not set its retail price at an unprofitable level in the short run merely to exclude competition in the long run.

MetroNet II at 1133. (Pet. App. 16a-17a.) This is likewise error. First, it ignores the only evidence in the record. Qwest had *NO* "procompetitive justification for per location pricing." *MetroNet I* at 1008. (Pet. App. 65a.) It was, and is undisputed, that per location pricing had *NO* cost-based justification. *Id.* Per location pricing did not enhance efficiency nor improve the products offered to consumers. *Id.* The only evidence in the record is that Qwest introduced per location pricing to crush competition. The Ninth Circuit's speculation about why Qwest introduced per location pricing is in error and flatly contradicted by the evidence. Second, once again, the Ninth Circuit draws inferences from the evidence in a light that is unfavorable to the nonmoving party, MetroNet. *Matsushita*, *supra* at 587.

The *Verizon* court also found significant the fact that in *Aspen Skiing* and *Otter Tail Power Co. v. U.S.*, 410 U.S. 366, 35 L. Ed. 2d 359, 93 S. Ct. 1022 (1973), the defendants had "refused to provide to its competitor . . . a product that it already sold at retail." *Verizon*, 157 L. Ed. 2d at 837. The same is true in MetroNet's case. Centrex Plus was sold at retail. Centrex Plus is not a product only found "deep within the bowels" of Qwest. *Verizon*, 157 L. Ed. 2d at 838.

The Ninth Circuit analyzed this language and found that MetroNet "is essentially asking this court to 'identify[] the proper price' that Qwest should charge in the retail market." *MetroNet II* at 1133. (Pet. App. 18a.) Again, the Ninth Circuit turns rules applied at summary judgment around. The court looks at certain behavior and draws inferences against MetroNet. This is an issue the jury should decide. *Matsushita*, *supra* at 587. MetroNet is not asking the court to identify any proper price for any product. MetroNet seeks to recover the damages it suffered as a result of a change in Qwest's behavior that was undertaken in order to maintain its monopoly.

Additionally, the Ninth Circuit's reasoning would undo every claim brought by a competitor based on anti-competitive pricing behavior. Every antitrust plaintiff who bases its claim on anti-competitive pricing behavior can be accused of "asking the court to identify the proper price." The Ninth Circuit opinion, rather than "preserv[ing] those 'claims that satisfy existing antitrust standards,'" would reject them. *Verizon*, 157 L. Ed. 2d at 835.

Lastly, in *Verizon*, the Court held that when there exists "a regulatory structure designed to deter and remedy anti-competitive harm," there was no need to

expand the contours of § 2 of the Sherman Act. *Verizon*, 157 L. Ed. 2d at 839. The Ninth Circuit analyzed the Washington regulatory scheme and concluded that "such a regulatory structure exists in this case." *MetroNet II* at 1135. (Pet. App. 20a.) The Ninth Circuit held that:

> . . . the record demonstrates that the WUTC has been attentive to Qwest's attempts to eliminate resale through per location pricing and has taken corrective action . . . .

Id. at 1136. (Pet. App. 22a.) The Ninth Circuit is wrong. The opposite is true.

It is true that the record reflects that MetroNet has fought the imposition of per location pricing at every turn. Despite this, and despite the fact that the WUTC found per location pricing discriminatory, it allowed Qwest to reimpose per location pricing on the features component of Centrex Plus by simply filing a price list in 1997. Re-imposition of per location pricing was a product of Qwest's independent judgment and initiative and therefore not deserving of implied immunity. *Phonetel, Inc. v. AT&T*, 644 F.2d 716, 735 (9th Cir. 1981), *cert. denied*, 459 U.S. 1145 (1983). The reimposition of per location pricing, as to the features component, raised the price 400 percent to consumers. (Pet. App. 104a.) Far from being attentive to Qwest's attempts, the WUTC stood by and did nothing to "correct" Qwest's reimposition of per location pricing. This is true even though the WUTC knew per location pricing was discriminatory. Far from showing that the regulatory scheme can prevent anti-competitive actions, like the imposition of per location pricing, what this shows is the total inability of regulators to stop, or even slow, an ILEC, like Qwest, if the incumbent company is intent on destroying competition.

Additionally, the Ninth Circuit's opinion is flatly contradicted by MetroNet's expert Dr. Cornell's declaration. (Pet. App. 162a-242a.) Dr. Cornell opined that the WUTC's "limited statutory authority, limited resources and the constraints of the regulatory process effectively left Qwest with considerable latitude in setting the prices for Centrex access." *MetroNet I* at 1005. (Pet. App. 60a.) *Also see*, Declaration of Nina W. Cornell in Support of Memorandum in Opposition to Motion for Summary Judgment. (Pet. App. 162a-242a.) Also, Qwest's ability for the last 15 years to ignore repeated WUTC orders to unbundle the Centrex components hardly reflects a regulatory scheme able to take "corrective action." *See MetroNet I* at 1005. (Pet. App. 60a.)

Dr. Cornell's opinion concerning the impotence of the regulatory scheme is shared by professors Areeda and Hovencamp. Regulatory agencies lack the resources necessary to stop powerful ILECs like Qwest from taking anticompetitive action. Professors Areeda and Hovencamp believe that Sherman Act § 2 claims should be brought:

> When the conduct threatens to expand monopoly beyond the scope intended by or adequately supervised by regulators . . . .

IIIA, *Antitrust Law*, P. Areeda and Hovencamp ¶ 787 p. 302 (2nd ed. 2002). At a minimum, this is an issue of fact that should be decided at trial.

With respect to the doctrine of essential facilities, the *Verizon* Court held that these claims should be denied where a state or federal agency has effective power to compel sharing. *Verizon*, 157 L. Ed. 2d at 838. Relying on this language, the Ninth Circuit affirmed the dismissal of MetroNet's essential facilities claim. *MetroNet II* at 1130.

(Pet. App. 10a.) "Effective" means producing a definite or desired result. *Webster New World Dictionary*, p. 445 (2nd ed. 1972). The facts of this case prove the WUTC did not have effective power to compel Qwest to give MetroNet meaningful access. Even after the WUTC had found per location pricing "discriminatory," all Qwest had to do was file a price list and per location pricing came back. With all due respect to the Court's opinion, all of the regulatory provisions in the world compelling access are useless against an incumbent like Qwest that seeks to thwart and suppress competition. In many circumstances, incumbents can simply withstand and hold out against any regulatory agency. For many small telecommunications companies, antitrust relief from a federal court is the only way to force incumbents to stop acting anticompetitively. It was error for the Ninth Circuit to dismiss MetroNet's essential facilities claim.

Finally, the United States Supreme Court should accept MetroNet's petition because there is a split in the Circuits which requires clarification. In the recent case of *Covad Communications Co. v. Bell Atlantic Corp.*, 398 F.3d 666 (D.C. Cir. 2005), the District of Columbia Circuit Court did not dismiss Covad's refusal to deal claim. In fact, the Court did not overlay the *Verizon* analysis. The same should happen in MetroNet's case.

CONCLUSION

MetroNet's petition for a writ of certiorari should be granted. The Ninth Circuit's opinion expands the scope and effect of the ruling in *Verizon*. The Ninth Circuit's opinion virtually eliminates refusal to deal claims in the telecommunications field. This is wrong and should not be the result of *Verizon*. *Verizon* expressly held that cases that derive from existing antitrust standards survive the 1996 Act. The Ninth Circuit's opinion is at odds with this view and therefore the United States Supreme Court should review the Ninth Circuit's opinion.

Respectfully submitted,

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383 F.3d 1124

METRONET SERVICES CORPORATION; MetroNet Telemanagement Corporation, Plaintiffs-Appellants,

v.

QWEST CORPORATION, Defendant-Appellee.

No. 01-35406.

United States Court of Appeals, Ninth Circuit.

Sept. 24, 2004.

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On Remand from the Supreme Court of the United States.

Before BROWNING, FISHER and TALLMAN, Circuit Judges.

FISHER, Circuit Judge:

The Supreme Court vacated our prior decision in this antitrust case, *MetroNet Serv's Corp. v. U S West Communications,* 329 F.3d 986 (9th Cir.2003), and remanded for further consideration in light of its recent decision in *Verizon Communications Inc. v. Law Offices of Curtis V.*

Trinko, LLP, 540 U.S. 398, 124 S.Ct. 872, 157 L.Ed.2d 823 (2004). *Qwest Corp. v. MetroNet Serv's Corp.*, ___ U.S. ___, 124 S.Ct. 1144, 157 L.Ed.2d 1040 (2004). Qwest Corp., formerly U S West Communications, is the incumbent local exchange carrier ("ILEC") serving the state of Washington.[1] After Qwest offered volume discounts on phone services to businesses with more than 20 phone lines, MetroNet Services Corp. and MetroNet Telemanagement Corp. (collectively "MetroNet") began purchasing those services from Qwest and reselling them to small businesses with 20 or fewer phone lines. MetroNet received the volume discounts by aggregating the phone lines of these small businesses. In 1997, in order to eliminate resale of its services, Qwest changed the pricing structure of its calling features and required that customers have at least 21 lines at each location in order to receive the volume discount.

In 2000, MetroNet filed suit alleging that Qwest violated Section 2 of the Sherman Act by illegally maintaining a monopoly over the market for small business local telephone services in the Seattle/Tacoma area, and by denying MetroNet access to an essential facility.[2] After MetroNet and Qwest engaged in settlement discussions, MetroNet moved to enforce a written, unsigned settlement agreement. The district court denied the motion and subsequently granted summary judgment in favor of Qwest on the remaining antitrust claims. In our original

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[1] We refer to Qwest Corp. and its predecessors simply as "Qwest."

[2] MetroNet also asserted a state law cause of action for breach of contract and the implied covenant of good faith and fair dealing. This cause of action was dismissed without prejudice by the district court on May 2, 2000 and is not before us.

decision, we reversed the grant of summary judgment and affirmed the denial of MetroNet's motion to enforce its settlement agreement with Qwest.

In light of *Verizon*, we now affirm summary judgment in favor of Qwest. MetroNet cannot prove an essential facilities claim, because the Telecommunications Act of 1996, Pub.L. No. 104-104, 110 Stat. 56 (1996), 47 U.S.C. § 151 *et seq.* ("1996 Act"), provides the means for MetroNet to obtain access to Qwest's local exchange network. In addition, Qwest's change in pricing in order to eliminate arbitrage does not amount to exclusionary conduct under the Supreme Court's refusal to deal precedents as interpreted by *Verizon*. Finally, we decline to expand antitrust liability to encompass MetroNet's claims because of their novel nature, the existence of a regulatory structure designed to deter and remedy anticompetitive harm and the record of the regulatory agency's attentiveness to the anticompetitive conduct alleged in this antitrust suit.

I. FACTUAL AND PROCEDURAL BACKGROUND

Qwest sells two types of business phone services relevant to this antitrust suit: flat-rate local exchange called "1FB"[3] and "Centrex." Centrex consists of two components: multiple telephone line access that allows a company's employees to make internal calls using a four-digit extension and external calls via the Qwest central office switch (the access component), and calling features such as call forwarding, call waiting and call hold (the

[3] "F" stands for "flat-rate" and "B" stands for "business." Flat-rate residential service is known as "1FR."

features component).[4] Although each component is priced separately, Qwest sells them as one bundled service, requiring customers who buy one component to buy the other as well.[5]

Qwest originally developed Centrex for the large business market as an alternative to private branch exchange ("PBX"), a switch owned by large businesses and located on their property.[6] Qwest initially offered volume discounts to large businesses with more than 20 phone lines. Small businesses with 20 or fewer lines could purchase Centrex without the discount, or purchase 1FB lines from Qwest as well as features for an additional fee.[7]

Qwest priced Centrex on a "per system basis," *i.e.* based on the number of phone lines included in the Centrex package, regardless of whether those lines ran to a single location or multiple, separate locations. This "system pricing" scheme allowed resellers to receive the volume discounts by aggregating the telephone lines of several variously located small businesses. As early as

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[4] MetroNet stresses that the access component itself consists of two sub-components: the physical line between the customer and Qwest's switch, called the network access channel ("NAC"), and a device that limits the number of lines that have access, called the network access register ("NAR"). Because our analysis does not depend on this further level of detail, we do not refer to it in the text.

[5] MetroNet has not alleged or argued that Qwest has engaged in illegal tying.

[6] A PBX allows four-digit internal calling and can provide some features. External dialing is done through Qwest's local network using a "trunk line" that connects the customer's PBX to the Qwest network.

[7] It is unclear from the record whether small business customers choosing to purchase 1FB lines could also buy features from providers other than Qwest.

1985, MetroNet and other resellers began purchasing volume discounted Centrex lines from Qwest and reselling them to aggregations of small businesses, each with 20 lines or fewer. MetroNet sold Centrex at a price above what it cost MetroNet to purchase Centrex from Qwest but below what MetroNet's customers would have had to pay for 1FB lines plus features.

By 1991, Qwest had taken note of the significant resale market for Centrex created by the differential pricing of Centrex and 1FB lines. Qwest sought to introduce a new version of Centrex, Centrex Plus, with a pricing structure designed to eliminate or reduce the arbitrage between Centrex and 1FB lines. Under the new "per location pricing" structure, Qwest required customers to have more than 20 lines *at each location* in order to receive a volume discount for the service to that location. Because the resellers' customers have 20 or fewer lines, Qwest's shift to per location pricing eliminated the resellers' ability to obtain the Centrex volume discounts.

The Washington Utilities and Transportation Commission ("WUTC") is authorized to regulate the rates, services, facilities and practices of telecommunications companies in the state of Washington. Wash. Rev.Code § 80.01.040(3)(2004). Qwest filed tariff changes with the WUTC for the new per location pricing structure, which would apply not only to the features component of Centrex, but also to the access component.[8] The WUTC conditionally approved per location pricing of Centrex Plus on

[8] To be more precise, the per location pricing scheme applied to the NAC subcomponent of Centrex access, not the NAR subcomponent. *See* note 4 *supra*.

November 18, 1993, and finally approved it on November 30, 1994. However, a year and a half later, on April 11, 1996, the WUTC abolished per location pricing and ordered that system pricing be reinstated. Qwest viewed the WUTC order as "exasperating dramatically the existing revenue arbitrage situation" and appealed. The Washington Supreme Court upheld the WUTC order. *U S West Communications, Inc. v. Wash. Utils. & Transp. Comm'n,* 134 Wash.2d 74, 949 P.2d 1337, 1364 (1998).

In December 1996, with system pricing back in place, Qwest concluded that:

> The current Washington tariff structure for Centrex Plus, [1FB], and features offers a profitable, relatively low risk opportunity for Centrex resellers to win significant market share of 1FB customers (mainly small business) in Washington. In essence, it appears that resellers can operate with positive margins while reselling [Centrex] at anywhere from 10 to 35 percent discounts to [1FB lines], not including features.

Qwest estimated that it was losing more than $300,000 in revenues per month to MetroNet and other resellers, and that the revenue loss was having a "significantly negative" impact on profitability. In addition to these financial concerns, Qwest was greatly troubled that the loss of its direct relationship with customers due to resale would deprive it of the opportunity to cross-sell additional products and services. Qwest concluded that "no existing or forthcoming product . . . effectively addresses Centrex resale competition," and set about developing strategies to win back market share. On April 18, 1997, Qwest filed a price list with the WUTC reinstating per location pricing for the

features component of Centrex. This later imposition of per location pricing is the subject of the present suit.

II. STANDARD OF REVIEW

We review de novo a district court's grant of summary judgment. *Balint v. Carson City,* 180 F.3d 1047, 1050 (9th Cir.1999) (en banc). We must determine, viewing the evidence in the light most favorable to the nonmoving party, whether there exist any genuine issues of material fact and whether the district court correctly applied the substantive law. *Id.* We may not weigh the evidence or determine the truth of the matter; rather, we may determine only whether there is a genuine issue for trial. *Id.* at 1054.

III. ESSENTIAL FACILITIES

MetroNet claims that Qwest denied resellers like MetroNet access to its local exchange network, an essential facility, by eliminating opportunities for Centrex resale. "The 'essential facilities' doctrine imposes on the owner of a facility that cannot reasonably be duplicated and which is essential to competition in a given market a duty to make that facility available to its competitors on a nondiscriminatory basis." *Ferguson v. Greater Pocatello Chamber of Commerce, Inc.,* 848 F.2d 976, 983 (9th Cir.1988). In order to prevail on its essential facilities claim, MetroNet must prove (1) that Qwest is a monopolist in control of an essential facility, (2) that MetroNet, as Qwest's competitor, is unable reasonably or practically to

duplicate the facility,[9] (3) that Qwest has refused to provide MetroNet access to the facility and (4) that it is feasible for Qwest to provide such access.[10] *See City of Anaheim v. S. Cal. Edison Co.*, 955 F.2d 1373, 1380 (9th Cir.1992).

Even though the essential facilities doctrine is followed in this and other circuits, the Supreme Court has "never recognized such a doctrine." *Verizon*, 124 S.Ct. at 881. In *Verizon*, the Court found "no need either to recognize [the doctrine] or to repudiate it" because the Court concluded that the plaintiff could not state a claim under the doctrine. *Id.* The Court reasoned "the indispensable requirement for invoking the doctrine is the unavailability of access to the 'essential facilities'; where access exists, the doctrine serves no purpose." *Id.* Thus, "essential facility claims should . . . be denied where a state or federal agency has effective power to compel sharing and to regulate its scope and terms." *Id.* (quoting Areeda & Hovenkamp, Antitrust Law ¶ 773e, at 150 (2003 Supp.)).

The Court's reasoning in *Verizon* compels affirmance of the district court's grant of summary judgment with respect to MetroNet's essential facilities claim. MetroNet cannot establish the first element of its claim, because the 1996 Act provides the WUTC with the effective power to

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[9] "[T]he second element is effectively part of the definition of what is an essential facility in the first place. That is to say, if the facility can be reasonably or practically duplicated it is highly unlikely, even impossible, that it will be found to be essential at all." *City of Anaheim v. S. Cal. Edison Co.*, 955 F.2d 1373, 1380 (9th Cir.1992).

[10] "[T]he fourth element basically raises the familiar question of whether there is a legitimate business justification for the refusal to provide the facility." *City of Anaheim*, 955 F.2d at 1380.

compel Qwest to share its local exchange network with competitors. Specifically, under the 1996 Act, a requesting competitive local exchange carrier ("CLEC") can obtain access to an incumbent carrier's network in three ways: "[i]t can purchase local telephone services at wholesale rates for resale to end users; it can lease elements of the [ILEC's] network 'on an unbundled basis'; and it can interconnect its own facilities with the [ILEC's] network." *AT & T Corp. v. Iowa Utils. Bd.,* 525 U.S. 366, 371, 119 S.Ct. 721, 142 L.Ed.2d 835 (1999); *see* 47 U.S.C. § 251(c)(2)-(4)(2004). The incumbent carrier can negotiate an agreement with the competitive carrier without regard to the duties it would otherwise have under § 251(c), but if private negotiations fail, either party can petition the relevant state commission to arbitrate unresolved issues. *See* 47 U.S.C. § 252 (2004); *AT & T,* 525 U.S. at 372-73, 119 S.Ct. 721. Thus, "[t]he 1996 Act's extensive provision for access makes it unnecessary to impose a judicial doctrine of forced access." *Verizon,* 124 S.Ct. at 881; *see Covad Communications Co. v. BellSouth Corp.,* 374 F.3d 1044, 1050 (11th Cir.2004) ("Where a state or federal agency is authorized to compel access to a competitor's infrastructure, as under the [1996 Act], [*Verizon*] states that an essential facilities claim should be denied.").

MetroNet contends that the compelled sharing provisions of the 1996 Act are irrelevant here because they have no effect on MetroNet's resale business. This argument misapprehends the purpose of the essential facilities doctrine. The doctrine makes a facility that is essential to competition in a given market available to competitors so that they may compete in that market. A facility is "essential" only if it is "*otherwise unavailable* and cannot be reasonably or practically replicated." *City of Anaheim,* 955

F.2d at 1380 (emphasis added). The doctrine does not guarantee competitors access to the essential facility in the most profitable manner. Even assuming that MetroNet can no longer profitably buy Centrex in the retail market and resell it to small businesses, MetroNet can still obtain access to Qwest's local exchange network through the compelled sharing provisions of the 1996 Act. *See* 47 U.S.C. § 251(c). Because reasonable access to the essential facility exists – even if not in a way that is conducive to MetroNet's existing business model – MetroNet cannot establish an essential facilities claim.

MetroNet also argues that the WUTC has no *effective* power to compel sharing due to the realities of the regulatory scheme. MetroNet relies on testimony by its expert that Qwest has considerable latitude in setting prices because of the WUTC's limited statutory authority, limited resources and other constraints of the regulatory process. Even were we to credit this testimony and find that the WUTC is unable to regulate *prices,* this would not show that the WUTC lacks effective power to compel *sharing.* The WUTC's statutory authority to compel sharing stems from the same 1996 Act provisions that the Court relied upon in *Verizon* to reject the plaintiff's essential facilities argument. *See Verizon,* 124 S.Ct. at 876. Moreover, the record shows that Qwest has entered into an interconnection agreement with MetroNet and that other telecommunications carriers have successfully petitioned the WUTC to arbitrate and approve interconnection agreements with Qwest. Thus, we conclude that the WUTC has the effective power to compel sharing under the 1996 Act.

IV. MONOPOLIZATION

We must also consider the impact of *Verizon* on MetroNet's monopolization claim under Section 2 of the Sherman Act. *See* 15 U.S.C. § 2 (2004) (making it illegal to "monopolize . . . any part of the trade or commerce among the several States"). To prevail on this claim, MetroNet must prove that Qwest (1) possessed monopoly power in the relevant market, (2) wilfully acquired or maintained that power through exclusionary conduct and (3) caused antitrust injury. *See Am. Prof'l Testing Serv., Inc. v. Harcourt Brace Jovanovich Legal & Prof'l Publ'ns, Inc.*, 108 F.3d 1147, 1151 (9th Cir.1997). *Verizon* does not address the meaning of monopoly power or antitrust injury, but does examine the element of exclusionary conduct.[11] *See Verizon*, 124 S.Ct. at 879.

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[11] MetroNet argues that *Verizon* has no impact on its case because of the differences in procedural posture. *Verizon* was decided on a motion to dismiss pursuant to Fed.R.Civ.P. 12(b)(6), *see Law Offices of Curtis V. Trinko, LLP v. Bell Atlantic Corp.*, 305 F.3d 89, 95-96 (2d Cir.2002), whereas the district court resolved this case on a motion for summary judgment. MetroNet says that our previous conclusion that it had created triable issues of fact is not disturbed by *Verizon*.

Nonetheless, *Verizon* affected whether Qwest's conduct can be considered anticompetitive as a matter of law. *See Verizon*, 124 S.Ct. at 879; *see also SmileCare Dental Group v. Delta Dental Plan of Cal., Inc.*, 88 F.3d 780, 783 (9th Cir.1996) ("Whether specific conduct is anticompetitive is a question of law reviewed de novo."). Contrary to MetroNet's contention, the procedural differences, if anything, make it more difficult for MetroNet's claims to survive summary judgment because the Court's dismissal in *Verizon* implied that the plaintiff could prove no set of facts that would entitle it to relief. *See id.* ("A complaint should not be dismissed [under Rule 12(b)(6)] unless it appears beyond doubt that [the] plaintiff can prove no set of facts in support of his claim which would entitle him to relief."). Thus, *Verizon* raises the threshold with respect to the facts that MetroNet must plead and prove to establish an antitrust violation.

A. Refusal to deal

The Court in *Verizon* stated that as a general matter "there is no duty to aid competitors." *Id.* at 881. It articulated three reasons for this general proposition. First, "[c]ompelling . . . firms to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities." *Id.* at 879. Second, "[e]nforced sharing also requires antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing – a role for which they are illsuited." *Id.* Third, "compelling negotiation between competitors may facilitate the supreme evil of antitrust: collusion." *Id.*

Although recognizing that "[u]nder certain circumstances, a refusal to cooperate with rivals can constitute anticompetitive conduct and violate § 2," the Court noted that it has been "very cautious in recognizing such exceptions." *Id.* The Court concluded that *Verizon* did not fit within the existing exceptions carved out by *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 105 S.Ct. 2847, 86 L.Ed.2d 467 (1985), or *Otter Tail Power Co. v. United States,* 410 U.S. 366, 93 S.Ct. 1022, 35 L.Ed.2d 359 (1973).

In *Aspen Skiing,* the defendant owned three of the four mountains in the Aspen, Colorado ski area, and the plaintiff owned the fourth mountain. They had jointly offered for many years a multiple-day, multiple-area ticket that gave skiers admission to all of the mountains (the "joint ticket"). *Aspen Skiing,* 472 U.S. at 589-90, 105 S.Ct. 2847. The joint ticket was often cheaper than purchasing multiple single-day tickets. *Id.* at 589, 105 S.Ct. 2847.

Revenues from the joint ticket were divided between the parties according to the relative percentage that buyers with the joint ticket used each mountain. *Id.* The defendant decided to discontinue the joint ticket by giving the plaintiff "an offer that it could not accept": the defendant would continue participating in the joint ticket only if the plaintiff agreed to receive a fixed percentage of joint ticket revenues that was considerably lower than the historical average based on actual usage of the fourth mountain. *Id.* at 592, 105 S.Ct. 2847. After the plaintiff rejected the offer, the defendant sold a joint ticket featuring only its three mountains. *Id.* at 593, 105 S.Ct. 2847. The plaintiff attempted to market its own multiple-day, multiple-area package by offering ski passes to the fourth mountain along with vouchers, each equal to the retail price of a single-day ticket to one of the defendant's mountains. *Id.* at 593-94, 105 S.Ct. 2847. The defendant refused to accept these vouchers and to sell any lift tickets to the plaintiff at retail price. The Supreme Court upheld a jury verdict in favor of the plaintiff on its claim that the defendant had monopolized the market for downhill skiing services in Aspen. *Id.* at 605, 105 S.Ct. 2847.

In *Verizon,* the Court explained *Aspen Skiing* in this way:

> The Court . . . found significance in the defendant's decision to cease participation in a cooperative venture. The unilateral termination of a voluntary (*and thus presumably profitable*) course of dealing suggested a willingness to forsake short-term profits to achieve an anticompetitive end. Similarly, the defendant's unwillingness to renew the ticket *even if compensated at retail price* revealed a distinctly anticompetitive bent.

Verizon, 124 S.Ct. at 879-80 (citations omitted). The Court then distinguished *Verizon* from *Aspen Skiing.* Because there were no allegations that Verizon had "voluntarily engaged in a course of dealing with its rivals, or would ever have done so absent statutory compulsion," Verizon's prior conduct "shed[] no light upon the motivation of its refusal to deal – upon whether its regulatory lapses were prompted not by competitive zeal but by anticompetitive malice." *Id.* at 880. The Court also observed that "[i]n *Aspen Skiing,* what the defendant refused to provide to its competitor was a product that it already sold at retail," whereas in *Verizon,* "the services allegedly withheld are not otherwise marketed or available to the public."[12] *Id.* Thus, the Court "conclude[d] that Verizon's alleged insufficient assistance in the provision of service to rivals is not a recognized antitrust claim under this Court's existing refusal-to-deal precedents." *Id.; see also Covad,* 374 F.3d at 1048.

MetroNet attempts to fit the present case into *Aspen Skiing's* exception to the general "no duty to deal" rule. Although this case is similar in certain respects, it does not fit comfortably in the *Aspen Skiing* mold. The circumstances that *Verizon* found significant for creating antitrust liability are not present here.

The first fact found relevant in *Verizon* was the unilateral termination of a voluntary and profitable course of dealing. *Verizon,* 124 S.Ct. at 880. In the Court's view, this fact "suggested a willingness to forsake short-term profits to achieve an anticompetitive end." *Id.* Here,

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[12] The Court also distinguished *Otter Tail* on this basis. *See Verizon,* 124 S.Ct. at 880.

although Qwest voluntarily sold Centrex to its customers, including resellers like MetroNet, on a per system price from 1985 to 1991, Qwest attempted to change this prior course of dealing after it realized that the resale of Centrex by MetroNet and others was having a "significantly negative" impact on its own profitability. Hence, Qwest was not forsaking short-term profits by switching from system pricing to per location pricing, but rather was attempting to increase its short-term profits. Qwest's termination of its prior course of dealing therefore "sheds no light" upon whether Qwest was "prompted not by competitive zeal but by anticompetitive malice." *Id.*

The second fact in *Aspen Skiing* to which *Verizon* attached significance was the defendant's refusal to sell tickets to the plaintiff *"even if compensated at retail price,"* thus "suggesting a calculation that its future monopoly retail price would be higher." *Id.* Similar to the unilateral termination of a prior profitable course of dealing, the defendant's refusal to sell to the plaintiff at the prevailing retail price, in the Court's view, indicated a willingness to sacrifice short-term benefits in order to obtain higher profits in the long run from the exclusion of competition. *See Aspen Skiing,* 472 U.S. at 608, 105 S.Ct. 2847. Here, Qwest has been willing to sell and has sold Centrex to MetroNet at its retail price. However, Qwest has set its retail price in a way that has made it unprofitable for MetroNet to buy and resell Centrex.[13] Thus, Qwest's per location pricing is analogous to the offer that the

[13] The record contains conflicting evidence about MetroNet's profitability after Qwest implemented per location pricing in 1997, but we take the facts in the light most favorable to MetroNet as we must on summary judgment.

defendant in *Aspen Skiing* made to the plaintiff – an offer that the defendant anticipated would not be profitable for the plaintiff to accept. An offer to deal with a competitor only on unreasonable terms and conditions can amount to a practical refusal to deal. *Cf. Del. & Hudson Ry. Co. v. Consol. Rail Corp.*, 902 F.2d 174, 179-80 (2d Cir.1990) (holding that even if there is no "outright refusal to deal," a denial of an essential facility can occur "if the terms of the offer to deal are unreasonable").

Nonetheless, Qwest's choice to switch to per location pricing does not have the same economic significance as the defendant's refusal to sell to the plaintiff at the retail price in *Aspen Skiing*. Qwest's switch to per location pricing does not entail a sacrifice of short-term benefits. Rather, it enables Qwest to maintain a price discrimination structure established before resellers entered the market for local telephone services.[14] Because Qwest voluntarily implemented the volume discount pricing structure before Centrex resale began to undercut its sales to small businesses, that pricing structure was presumably maximizing Qwest's profits. Therefore, by price discriminating through per location pricing, Qwest has not

[14] Price discrimination describes the practice of charging different prices to different customers for essentially the same product or service. More technically, price discrimination occurs when a firm sells to different groups of customers at differing ratios of price to marginal cost. *See* 3 Areeda & Hovenkamp, Antitrust Law ¶ 721b, at 262 (2d ed.2002). It appears that Qwest is able to price discriminate among consumers because small businesses have a lower elasticity of demand than large businesses. In other words, large businesses are more sensitive to changes in price due to the availability of substitutes to Centrex, namely PBXs. Small businesses are willing to pay a higher price for Centrex because fewer substitutes for Centrex are available to them.

set its retail price at an unprofitable level in the short run merely to exclude competition in the long run.

The third fact the Court emphasized in *Verizon* was that the defendants in *Aspen Skiing* and *Otter Tail* refused to provide to their competitors products that were already sold in a retail market to other customers. *Verizon,* 124 S.Ct. at 880. The importance of this fact relates to the Court's concern about the administrability of a judicial remedy. One of the reasons for a general "no duty to deal" rule is that enforced sharing "requires antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing – a role for which they are ill-suited." *Id.* at 879. If the defendant already sells the product in an existing market to certain customers but merely refuses to sell to its competitors, the court can impose a judicial remedy that does not require the court to "assume the day-to-day controls characteristic of a regulatory agency." *Id.* at 883 (quoting Areeda, *Essential Facilities: An Epithet in Need of Limiting Principles,* 58 Antitrust L.J. 841, 853 (1989)). The court can simply order the defendant to deal with its competitors on the same terms that it already deals with others in the existing retail market, without setting the terms of dealing. In contrast, if the defendant does not already provide the product in an existing market or otherwise make it available to the public, the court will have to delineate the defendant's sharing obligations, and "[a]n antitrust court is unlikely to be an effective day-to-day enforcer of these detailed sharing obligations." *Id.*

In this case, Centrex is a service already sold in a retail market. Qwest, however, has not refused to sell this

retail service to MetroNet, but has sold it to MetroNet on the same terms that it sells to direct consumers.[15] Like direct consumers, MetroNet must have more than 20 lines at the same location in order to receive a volume discount on Centrex features. Thus, MetroNet is essentially asking this court to "identify[] the proper price" that Qwest should charge in the retail market – a role the Supreme Court has deemed courts ill suited to perform. *Id.* at 879.

In sum, *MetroNet* does not fall within the *Aspen Skiing* exception to the general "no duty to deal" rule, because Qwest's switch to per location pricing does not entail a sacrifice of short-term profits for long-term gain from the exclusion of competition and because Qwest has not refused to deal with MetroNet on the same terms that it deals with direct consumers. Therefore, MetroNet does not have an actionable antitrust claim under the Supreme Court's existing refusal to deal precedents as explained and limited by *Verizon*.

B. Elimination of arbitrage

In our previous decision, we did not rely on the existing refusal to deal doctrine to conclude that Qwest could be liable under the Sherman Act for monopolization. *MetroNet,* 329 F.3d at 1006-08. Instead, analogizing to cases which had condemned collaborative efforts to eliminate discounters, we extended antitrust liability to Qwest's unilateral attempt to eliminate discount resellers like MetroNet. *Id.* at 1007. *Verizon* teaches, however, that the

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[15] Qwest discriminates in price among different types of direct consumers (small businesses versus large businesses) but does not discriminate between competitors and direct consumers.

regulatory context is an important consideration in "deciding whether to recognize an expansion of the contours of § 2." *Verizon,* 124 S.Ct. at 881.[16] To determine whether we should expand the contours of Section 2 liability in a regulated industry, we must weigh the "benefits of antitrust intervention" against "a realistic assessment of its costs." *Id.* at 882.

With regard to the benefits of antitrust intervention, we recognize that imposing antitrust liability on sellers who unilaterally attempt to eliminate resellers can deter attempts to eliminate arbitrage that is beneficial to consumer welfare. A reseller can engage in arbitrage when a seller price discriminates among its consumers. In particular, if a seller charges a higher price to some consumers (the "disfavored consumers") and a lower price to others (the "favored consumers"), a reseller can take advantage of this price differential by buying the product or service at the lower price intended for the favored consumers and reselling it to the disfavored consumers at a price below the price the seller charges the disfavored consumers. *See* 3 Areeda & Hovenkamp, Antitrust Law ¶ 721b, at 263 (2d ed.2002).

Prohibiting sellers from eliminating arbitrage thus can enhance consumer welfare under certain conditions. For instance, if the seller's increase in profits from a greater number of sales due to the discounted price outweighs the loss in profits from the decrease in sales at the higher price due to customers switching to the reseller, the

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[16] The Supreme Court recognized, however, that the regulatory scheme created by the 1996 Act does not shield regulated entities from antitrust scrutiny altogether under the doctrine of implied immunity. *Verizon,* 124 S.Ct. at 878.

seller would find it profitable to continue to offer the product or service at a discounted price despite the presence of arbitrage and an inability to eliminate it. Consequently, favored consumers would still be able to purchase the product or service at the lower discounted price from the seller. In addition, some disfavored consumers who were willing to pay the seller's higher price could buy the product or service at a lower price from the reseller, and other disfavored consumers who were unwilling to pay the seller's higher price might be willing to buy the product at the reseller's lower price. Under these conditions, deterring the seller from eliminating arbitrage would increase consumer welfare and allocative efficiency.

In *Verizon,* however, the Supreme Court noted that where "a regulatory structure designed to deter and remedy anticompetitive harm . . . exists, the additional benefit to competition provided by antitrust enforcement will tend to be small." 124 S.Ct. at 881. Such a regulatory structure exists in this case. Under the Washington regulatory scheme, Qwest must file tariff schedules with the WUTC regarding its rates, which must be "fair, just, reasonable and sufficient," and may not change its filed tariff rates unless it gives 30 days notice to the WUTC and the public. Wash. Rev.Code §§ 80.36.080, .100, .110(1)(a). The WUTC can suspend proposed changes within this 30-day period or before they are due to go into effect, whichever is later. *Id.* § 80.36.110(1)(a). In addition, the WUTC may on its own initiative or upon complaint hold a hearing to determine whether the rates being charged are "unjust, unreasonable, unjustly discriminatory or unduly preferential, or in anywise in violation of law." *Id.* §§ 34.05.413, 80.36.140. If the WUTC finds in the affirmative, it "shall

determine the just and reasonable rates" and fix such rates by order. *Id.* § 80.36.140.

The WUTC may classify a telecommunications service as competitive if it is subject to "effective competition," which "means that customers of the service have reasonably available alternatives and that the service is not provided to a significant captive customer base." *Id.* § 80.36.330(1). The WUTC may require a competitive service to be provided under a price list, and 10 days notice must be given to the WUTC and customers for changes to rates filed in a price list. *Id.* § 80.36.110(1)(b), .330(2). Moreover, the WUTC "may investigate prices for competitive telecommunications services upon complaint," in which case Qwest would have to prove that the prices charged are "fair, just, and reasonable." *Id.* § 80.36.330(4). The WUTC may also "reclassify any competitive telecommunications service if reclassification would protect the public interest." *Id.* § 80.36.330(7).

In addition to the regulatory structure that exists, the record shows that the WUTC has been attentive to Qwest's attempts to eliminate Centrex resale and to price discriminate through per location pricing. The WUTC classified Centrex features as a competitive service in 1987 after hearing testimony from Dr. Nina Cornell, MetroNet's expert in this case, that Qwest's ability to price discriminate prevented effective competition. The WUTC nevertheless concluded that Centrex features were subject to effective competition. In 1992, after Qwest filed a price list revision to implement per location pricing for Centrex, the WUTC on its own initiative issued a complaint and instituted an investigation into whether Centrex features should be reclassified as noncompetitive. After conducting several days of hearings, the WUTC found that reclassifying

Centrex features as noncompetitive would not protect the public interest. In 1995, the WUTC suspended Qwest's tariff revisions and ordered Qwest to refile tariffs for Centrex without the per location requirement, which Qwest did. When Qwest filed a price list in 1997 re-implementing per location pricing for Centrex *features*, the WUTC held an open meeting during which MetroNet urged the WUTC to reject the price list, arguing that the per location pricing was designed to eliminate resellers and was thus inconsistent with the WUTC's prior orders.[17] Despite this testimony, the WUTC accepted its staff's recommendation to allow the price list to go into effect without taking any action.

In sum, the record demonstrates that the WUTC has been attentive to Qwest's attempts to eliminate resale through per location pricing and has taken corrective action when it found Qwest's conduct to be in violation of the regulatory framework. Thus, the additional benefits of antitrust intervention would tend to be small given the existence of a regulatory structure designed to deter and remedy anticompetitive harm and the record of the WUTC's attentiveness to the alleged anticompetitive conduct. *See Verizon,* 124 S.Ct. at 881-82; Areeda & Hovenkamp, Antitrust Law ¶ 242, at 39 (2004 Supp.).

On the other side of the scale, the costs from antitrust intervention might be significant. Prohibiting a seller from eliminating arbitrage can diminish consumer welfare and

[17] There is no evidence in the record, however, that MetroNet filed a petition to reclassify Centrex features as a noncompetitive service or a complaint that per location pricing for Centrex features was unfair, unjust or unreasonable.

allocative efficiency in the long run under some circumstances. For instance, a seller may charge different prices to favored and disfavored consumers in order to recover the common costs of serving both sets of consumers. *See* Einer Elhauge, *Why Above-Cost Price Cuts to Drive Out Entrants are not Predatory – and the Implications for Defining Costs and Market Power,* 112 Yale L.J. 681, 732-33 (2003). If the seller cannot eliminate arbitrage, its sales to the disfavored (and higher-paying) consumers might be significantly – if not completely – undercut by the reseller to the extent that the seller can no longer recoup its common costs. As a result, the seller might choose not to incur common costs that are necessary for the development of economically beneficial facilities.

Alternatively, the seller might choose not to offer a discounted price in the first place and instead charge a uniform price to all consumers. If the uniform price it would set is as high as the price the seller would have charged the disfavored consumers if price discrimination could be maintained, consumer welfare would diminish. All consumers, including those who otherwise would have been favored if price discrimination were sustainable, would have to pay the high uniform price, and some potential consumers who are not willing to pay the high uniform price but would have been willing to pay a lower price that is above the marginal cost to provide the service or product would forgo it. *See* 3 Areeda & Hovenkamp, Antitrust Law ¶ 721d1, at 266-68 (2d ed.2002). Hence, consumer welfare would diminish, and allocative efficiency would be distorted.

Although courts ideally would not impose antitrust liability on a seller for eliminating arbitrage under such circumstances, a mistaken inference by a factfinder in an

antitrust suit could result in the false condemnation of an attempt to preserve a price discrimination scheme that increases consumer welfare or allocative efficiency. The Court observed in *Verizon* that "[m]istaken inferences and the resulting false condemnations are especially costly, because they chill the very conduct the antitrust laws are designed to protect." *Verizon,* 124 S.Ct. at 882 (internal quotation marks omitted). Here, a false condemnation could hurt the very interest the antitrust laws seek to protect – consumer welfare. *See Reiter v. Sonotone Corp.,* 442 U.S. 330, 343, 99 S.Ct. 2326, 60 L.Ed.2d 931 (1979) ("Congress designed the Sherman Act as a 'consumer welfare prescription.'") (quoting Robert H. Bork, The Antitrust Paradox 66 (1978)); *accord Rebel Oil Co. v. Atlantic Richfield Co.,* 51 F.3d 1421, 1433 (9th Cir.1995). Moreover, the risk of false condemnations and the resulting imposition of treble damages in private suits may be enough to deter sellers from attempting to eliminate arbitrage that is not beneficial to consumer welfare or from engaging in socially desirable price discrimination in the first place. Thus, "[t]he cost of false positives counsels against an undue expansion of § 2 liability." *Verizon,* 124 S.Ct. at 882.

We recognize that a unilateral attempt by a seller to eliminate arbitrage can result in anticompetitive harm. If "[t]here [were] nothing built into the regulatory scheme which performs the antitrust function, the benefits of antitrust [would be] worth its sometimes considerable disadvantages." *Id.* at 881 (internal citation and quotation marks omitted). Even in the presence of such a regulatory scheme, a plaintiff may be able to pursue an antitrust claim based on existing antitrust standards. *See Covad,* 374 F.3d at 1052 (reversing the dismissal of a price

squeeze claim after *Verizon*). However, given the novel nature of MetroNet's claims, the regulatory structure that exists and the record of agency action in this case – and guided by *Verizon* – we decline to expand the scope of Section 2 liability to Qwest's attempts to eliminate arbitrage by MetroNet.

V. CONCLUSION

We affirm the district court's grant of summary judgment on MetroNet's essential facilities and monopolization claims. We also affirm the denial of MetroNet's motion to enforce its purported settlement agreement with Qwest for the reasons stated in our previous opinion. *See MetroNet,* 329 F.3d at 1013-15. In all other respects, our prior opinion is superseded by our opinion today. Each party shall bear its own costs.

AFFIRMED.

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

METRONET SERVICES CORPORATION; et al., Plaintiffs-Appellants, v. US WEST COMMUNICATIONS, Defendant-Appellee.	No. 01-35406 D.C. No. CV-00-00013-JCC **JUDGMENT**

Appeal from the United States District Court for the Western District of Washington (Seattle).

This cause came on to be heard on the Transcript of the Record from the United States District Court for the Western District of Washington (Seattle) and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be, and hereby is **AFFIRMED**.

Filed and entered Friday, September 24, 2004

540 U.S. ___, 124 S. Ct. 1144, 157 L. Ed. 2d 1040 (2004)

No. 03-241. Qwest Corporation, Petitioner v MetroNet Services Corporation.

January 20, 2004. On petition for writ of certiorari to the United States Court of Appeals for the Ninth Circuit. Petition for writ of certiorari granted. Judgment vacated, and case remanded to the United States Court of Appeals for the Ninth Circuit for further consideration in light of Verizon Communications Inc. v Law Offices of Curtis V. Trinko, LLP, 540 US ___, 157 L Ed 2d 823, 124 S Ct ___ (2004).

Same case below, 329 F3d 986.

329 F.3d 986

METRONET SERVICES CORPORATION; Metronet Telemanagement Corporation, Plaintiffs-Appellants,

v.

US WEST COMMUNICATIONS, Defendant-Appellee.

No. 01-35406.

United States Court of Appeals, Ninth Circuit

Argued and Submitted Oct. 10, 2002.

Filed March 31, 2003.

Amended May 21, 2003.

James L. Phillips, Brooks E. Harlow, Miller Nash LLP, Seattle, WA, for the plaintiffs-appellants.

Thomas L. Boeder, Julia Parsons Clarke and Brent Snyder, Perkins Coie LLP, Seattle, WA, for the defendant-appellee.

Jonathan M. Askin, Association for Local Telecommunications Services, Washington, DC, and James E. Hartley, Thomas P. Howard and Thorvald A. Nelson, Holland & Hart LLP, Denver, CO, for the amicus curiae Association for Local Telecommunications Services.

Appeal from the United States District Court for the Western District of Washington; John C. Coughenour, Chief U.S. District Judge, Presiding. D.C. No. CV-00-00013-JCC.

Before BROWNING, FISHER and TALLMAN, Circuit Judges.

ORDER AMENDING OPINION AND DENYING JOINT PETITION FOR PANEL REHEARING AND PETITION FOR REHEARING EN BANC AND AMENDED OPINION

ORDER

The panel has voted to deny appellees' joint petition for panel rehearing and petition for rehearing en banc, filed April 21, 2003.

The full court has been advised of the petition for rehearing en banc and no judge of the court has requested a vote on whether to rehear the matter en banc. Fed. R.App. P. 35.

The opinion filed March 31, 2003, is amended as follows:

At slip op. 4495, line 9, replace the sentence beginning "It is undisputed" with the following:

> It is undisputed that per location pricing has no cost-based justification, *compare Oahu Gas,* 838 F.2d at 368 (economic necessity justified allegedly exclusionary conduct), and Qwest has not suggested how per location pricing enhances efficiency or improves the products offered to consumers, *see Microsoft,* 253 F.3d at 59.

At slip op. 4503, line 3, italicize "any."

At slip op. 4503, line 5, replace the phrase "but the second is erroneous." with "; the second overstates MetroNet's burden."

At slip op. 4503, line 8, insert the phrase "due to per location pricing" between the words "profitability" and "was".

At slip op. 4503, line 13, replace the sentence beginning "As to the second requirement" and the accompanying citation with the following:

> As to the second requirement, MetroNet need not prove that all of its financial woes were caused by per location pricing; rather, it must show that the financial harm attributable to per location pricing – apart from the financial harm due to other causes – was alone sufficient to drive it out of the market. *See Alaska Airlines,* 948 F.2d at 545-46.

At slip op. 4503, line 18, insert the phrase "and other resellers" after "driving it".

At slip op. 4503, line 32, add the following sentence after "this evidence of the injury to MetroNet is weak.": "So too is the evidence of injury to other resellers."

At slip op. 4504, line 1, replace the phrase "has had the effect of driving MetroNet away" with "alone had a sufficiently adverse financial impact to drive MetroNet and other resellers away." Also, add the following:

> *Id.* at 546 ("When a firm's power to exclude rivals from a facility gives the firm the power to *eliminate* competition in a market downstream from the facility, and the firm excludes at least some competitors . . . a finding of monopolization, or at least attempted monopolization, is appropriate . . ." (emphasis in original)). Qwest came forward with some evidence of other reasons for MetroNet's unprofitability, but this evidence is

insufficient to resolve the issue in Qwest's favor on summary judgment.

The panel having adopted these amendments, appellees' joint petition for panel rehearing and petition for rehearing en banc, filed April 21, 2003, is DENIED.

OPINION

FISHER, Circuit Judge.

This antitrust case involves the market for small business local telephone services in the Seattle/Tacoma area. Defendant-Appellee Qwest, formerly known as "U S West," owns the local telephone network in 14 western states, including Washington. In addition to selling basic flat-rate business lines, Qwest also sells "Centrex," a product offering volume discounted phone line access and calling features (e.g., voice mail and call forwarding) to businesses with more than 20 phone lines. Plaintiffs-Appellants MetroNet Services Corp. and MetroNet Telemanagement Corp. ("MetroNet") purchase Centrex from Qwest and resell it to small businesses in the Puget Sound region with 20 or fewer phone lines. By aggregating the phone lines of these small businesses, MetroNet is able to meet the Centrex 21-line minimum and pass on Centrex volume discounts to MetroNet's customers. In 1997, Qwest changed the pricing structure of the features component of Centrex in order to eliminate resale of both the access and features components. By requiring that each *location* receiving discounted Centrex features have at least 21 lines, Qwest's new pricing scheme rendered MetroNet's customers ineligible for the volume discount on features. MetroNet claims that Qwest's imposition of "per location pricing" violated Section 2 of the Sherman Act by illegally

maintaining a monopoly over the market for small business local telephone services in Seattle/Tacoma, and by denying MetroNet access to an essential facility. MetroNet appeals the district court's grant of summary judgment in favor of Qwest, arguing that the district court ignored conflicting evidence, improperly weighed evidence and failed to view the facts in the light most favorable to the nonmoving party, MetroNet.[1] MetroNet also appeals the district court's denial of its motion to enforce a written but unsigned settlement agreement with Qwest.

We hold that at this stage in the proceedings, the district court's grant of summary judgment was in error. Although it is indeed a close question, we hold, viewing the record in the light most favorable to MetroNet, that MetroNet has created triable issues of fact sufficient to proceed on its antitrust claims. We affirm the district court's denial of MetroNet's motion to enforce its settlement agreement with Qwest.

FACTUAL AND PROCEDURAL HISTORY

Qwest sells two types of business phone services relevant to this antitrust suit: flat-rate local exchange lines called "1FB lines,"[2] and "Centrex." Centrex consists of two components: multiple telephone line access that allows a company's employees to make internal calls using a four-digit extension and external calls via the Qwest

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[1] MetroNet has not challenged on appeal the district court's grant of summary judgment on its claim of attempted monopolization under Section 2 of the Sherman Act.

[2] "F" stands for "flat-rate" and "B" stands for "business." Flat-rate residential service is known as "1FR."

central office switch (the access component), and calling features such as call forwarding, call waiting and call hold (the features component).[3] The access component of Centrex is regulated by the Washington Utilities and Transportation Commission ("WUTC"), while the features component is not.[4] Although each component is priced separately, Qwest sells them as one bundled product, requiring customers who buy one component to buy the other as well.

Qwest originally developed Centrex for the large business market as an alternative to the private branch exchange ("PBX"), a switch owned by large businesses and located on their property.[5] Centrex obviated the need for such a switch and provided significant volume discounts to businesses with more than 20 phone lines. Small businesses with 20 or fewer lines could not take advantage of Centrex volume discounts; instead, they could purchase Centrex without the discount, or purchase 1FB lines from Qwest and features for an additional fee.[6]

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[3] MetroNet stresses that the access component itself consists of two subcomponents: the physical line between the customer and Qwest's switch, called the network access channel ("NAC"), and a device that limits the number of lines that have access, called the network access register ("NAR"). Because our analysis does not depend on this further level of detail, we do not refer to it in the text.

[4] The WUTC deregulated the features component in 1987. *See Wash. Utils. & Transp. Comm'n v. Pac. Northwest Bell Tel. Co.*, 83 P.U.R.4th 380, 1987 WL 257925 (Wash.U.T.C. Apr.07, 1987).

[5] A PBX allows four-digit internal calling and can provide some features. External dialing is done through Qwest's local network using a "trunk line" that connects the customer's PBX to the Qwest network.

[6] It is unclear from the record whether small business customers choosing to purchase 1FB lines could also buy features from providers other than Qwest.

As early as 1985, MetroNet and other resellers began purchasing volume discounted Centrex lines from Qwest and reselling them to aggregations of small businesses, each with 20 lines or fewer. The resellers thereby allowed small businesses to take advantage of the volume discounts previously available only to large businesses. MetroNet reaped profits by reselling Centrex at a price above what it cost MetroNet to purchase Centrex from Qwest but below what MetroNet's customers would have had to pay for 1FB lines plus features.

"Per location pricing"

By 1991, Qwest had taken note of the significant resale market for Centrex created by the differential pricing of Centrex and 1FB lines.[7] Qwest sought to introduce a new version of Centrex, Centrex Plus, with a pricing structure designed to "eliminate or reduce" the "arbitrage" between Centrex and 1FB lines. Under the old Centrex product, Qwest charged Centrex customers, including resellers like MetroNet, based on the number of phone lines included in the Centrex package, regardless of whether those lines ran to a single location or multiple, separate locations. This policy of "system pricing" allowed resellers to obtain the volume discounts of a single large business by aggregating the telephone lines of several variously located small businesses. With the introduction of Centrex Plus, however, Qwest intended to shift from system pricing to "per location pricing," requiring customers to have more

[7] The pricing differential between Centrex and 1FB lines had become so great that a significant number of small business customers were purchasing Centrex from resellers rather than 1FB lines from Qwest.

than 20 lines *at each location* in order to receive a volume discount for the service to that location. Because the resellers' customers have 20 or fewer lines, Qwest's shift to per location pricing would eliminate the resellers' ability to pass on the Centrex volume discount.

Qwest had to seek WUTC approval for the new pricing structure because per location pricing was to apply not only to the unregulated features component of Centrex, but also to the regulated access component.[8] The WUTC conditionally approved per location pricing of Centrex Plus on November 18, 1993, and finally approved it on November 30, 1994. However, a year and a half later, on April 11, 1996, the WUTC abolished per location pricing and ordered that system pricing be reinstated. *See Wash. Utils. & Transp. Comm'n v. U S West Communications, Inc.,* 169 P.U.R. 4th 417, 1996 WL 350826 (Wash.U.T.C., Apr.11, 1996). The WUTC found that "the existing arrangements are discriminatory and in practice operate to benefit [Qwest]." *Id.*

Qwest viewed the WUTC order as "exasperating dramatically the existing revenue arbitrage situation" and appealed. The Washington Supreme Court upheld the WUTC order. *US West Communications, Inc. v. Wash. Utils. & Transp. Comm'n,* 134 Wash.2d 74, 949 P.2d 1337, 1364 (Wash.1997).

In December 1996, with system pricing back in place, Qwest concluded that:

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[8] To be more precise, the per location pricing scheme applied to the NAC subcomponent of Centrex access, not the NAR subcomponent. *See* note 3 *supra.*

> The current Washington tariff structure for Centrex Plus, [1FB], and features offers a profitable, relatively low risk opportunity for Centrex resellers to win significant market share of 1FB customers (mainly small business) in Washington. In essence, it appears that resellers can operate with positive margins while reselling [Centrex] at anywhere from 10 to 35 percent discounts to [1FB lines], not including features.

Qwest estimated that it was losing more than $300,000 in revenues per month to MetroNet and other resellers, and that the revenue loss was having a "significantly negative" impact on profitability. In addition to these financial concerns, Qwest was greatly troubled that the loss of its direct relationship with customers due to resale would deprive it of the opportunity to cross-sell additional products and services. Qwest concluded that "no existing or forthcoming product . . . effectively addresses Centrex resale competition," and set about developing strategies to win back market share.

On April 18, 1997, Qwest filed a "price list" with the WUTC reinstating per location pricing for the deregulated features component of Centrex. This later imposition of per location pricing is the subject of the present suit. As a result, the small business customers of resellers such as MetroNet had to pay dramatically higher prices for Centrex features.[9]

MetroNet's chief executive officer, Kenneth Seeley, estimated that the cost of Centrex features increased 400 percent for his customers. MetroNet expert Dr. Nina

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[9] We infer from the record that MetroNet passed the increased cost of Centrex features on to its customers.

Cornell reported that resale customers had to pay nearly six times more for Centrex features than did medium-sized businesses (who presumably qualified for the per location volume discount). According to MetroNet, per location pricing also caused a slow but sure decline in MetroNet's profitability. It is unclear from the record whether this decline in profitability actually resulted in a net loss in 1999 and 2000. MetroNet's CEO Seeley claimed that MetroNet lost money in 1999 and 2000. However, MetroNet's bookkeeper testified that MetroNet was profitable in 1999.[10] The bookkeeper did not address overall profitability in 2000, but testified that for the first nine months of that year, MetroNet's revenues from the resale of Centrex exceeded MetroNet's cost of purchasing Centrex from Qwest.

Qwest contends that the number of Centrex telephone lines resold by MetroNet continued to grow for a year after the adoption of per location pricing, and that this fact demonstrates that MetroNet did not suffer any harm from per location pricing. Qwest also contends that any decline in MetroNet's profitability was due not to per location pricing, but rather to the entry of new competitors after passage of the Telecommunications Act of 1996, the precipitous drop in 1FB

[10] In its reply brief, MetroNet misconstrues the bookkeeper's testimony. The bookkeeper testified that in 1999 MetroNet experienced billing differences of $503,426 between what it paid Qwest for Centrex and what it earned from resale. MetroNet claims that the $503,426 was a net loss to MetroNet. In other words, MetroNet claims that it paid $503,426 more to Qwest for Centrex than it earned through resale. It is clear from the transcript of the bookkeeper's deposition, however, that the $503,426 billing difference was a surplus, not a net loss. In 1999, MetroNet resold Centrex for $503,426 more than it paid Qwest. The bookkeeper's testimony is unambiguous, and thus there is a direct conflict between his testimony and that of MetroNet CEO Seeley.

rates imposed by the WUTC in 1998, the advent of competing modes of access such as T-1 [11] and DSL [12] and heavy personnel turnover at MetroNet. Qwest also contends that regulation by the WUTC and the requirements of the Telecommunications Act of 1996 prevent it from controlling prices and excluding resellers such as MetroNet.

The Telecommunications Act of 1996

The Telecommunications Act of 1996, Pub.L. No. 104-104, 110 Stat. 56 (1996), *codified at* 47 U.S.C. § 151 *et seq.* ("1996 Act"), mandates a fundamental restructuring of the local telephone markets in all 50 states, including Washington. *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 371, 119 S.Ct. 721, 142 L.Ed.2d 835 (1999). Prior to passage of the 1996 Act, local exchange carriers ("LECs") like Qwest held exclusive state-granted franchises in their respective local telephone markets. *Id.* Thus, Qwest had a 100 percent share in the market for local telephone services in its 14-state region, including Washington. The 1996 Act formally abolished these exclusive franchises by prohibiting states from enforcing laws that impede competition and by imposing a host of duties on *incumbent* local

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[11] T-1 line is a dedicated phone connection supporting high speed data transmission. Each line "actually consists of 24 individual channels, each of which supports 64Kbits per second. Each 64Kbit/second channel can be configured to carry voice or data traffic. Most telephone companies allow you to buy just some of these individual channels, known as *fractional T-1* access. T-1 lines are a popular leased line option for businesses connecting to the Internet. . . ." Webopedia, *T-1 carrier, at* http://www.webopedia.com/TERM/T/T-1-carrier.html.

[12] "DSL" stands for "digital subscriber lines." DSL technology allows data to be transmitted over existing copper telephone lines at very high speeds, and thereby greatly facilitates use of the Internet. Webopedia, *xDSL, at* http://www.webopedia.com/TERM/x/xDSL.html.

exchange carriers ("ILECs") such as Qwest. 47 U.S.C. §§ 251, 253.

Most importantly, the 1996 Act imposed a duty on ILECs to share their networks with new local telephone providers, known as competitive local exchange carriers ("CLECs"). *Id.* § 251(c). "Under this provision, a requesting [CLEC] can obtain access to an [ILEC's] network in three ways: It can purchase local telephone services at wholesale rates for resale to end users; it can lease elements of the [ILEC's] network 'on an unbundled basis'; and it can interconnect its own facilities with the [ILEC's] network." *AT&T Corp.*, 525 U.S. at 371, 119 S.Ct. 721; 47 U.S.C. § 251(c)(2-4). Both interconnection and unbundled access must be provided "at any technically feasible point" in the carrier's network, and on "rates, terms and conditions that are just, reasonable, and nondiscriminatory." 47 U.S.C. § 251(c)(2-3). ILECs may not impose unreasonable conditions or limitations on the resale of telecommunications services to CLECs. *Id.* § 251(c)(4).[13]

When a CLEC seeks access to an ILEC's network through any of the three routes described above, the incumbent can negotiate an agreement without regard to the duties imposed by § 251. *Id.* § 252(a)(1); *see also AT&T Corp.*, 525 U.S. at 372-73, 119 S.Ct. 721. However, if negotiations break down, either party may petition the relevant state commission – in this case the WUTC – to arbitrate the dispute, and the state commission must

[13] However, "a State commission may, consistent with regulations prescribed by the Commission under this section, prohibit a reseller that obtains at wholesale rates a telecommunications service that is available at retail only to a category of subscribers from offering such service to a different category of subscribers." *Id.* § 251(c)(4)(B).

ensure that any resolution meets the requirements of § 251 and its implementing regulations. *See* 47 U.S.C. § 252(b)(1) & (c); *see also AT&T Corp.*, 525 U.S. at 373, 119 S.Ct. 721. The 1996 Act charged the Federal Communications Commission ("FCC") with issuing implementing regulations, but left the determination of rates in the hands of state commissions such as the WUTC, subject to the broad pricing standards set forth in the 1996 Act. *See* 47 U.S.C. §§ 251(d), 252(d).

New Entrants

The parties do not dispute the terms of the 1996 Act – only its practical effect on the market for small business local phone services in Seattle/Tacoma. It is undisputed that since passage of the 1996 Act, Qwest's market share has declined by 4.2 percent, from 100 to 95.8 percent. Relying solely on MetroNet's draft marketing plan for 2000, Qwest argues that the 1996 Act has ushered in an era of significant and effective competition. The draft report, prepared by sales manager Robert Beckett and quality assurance manager Brian Tatman, stated that "MetroNet . . . has seen the number of competitive providers go from solely U S West to over 17 in the past three years . . . . The flood of competition has produced a never ending push for customers to switch services to a new provider." "MetroNet has lost an average of 220 lines per month, with a total loss of 5721 since January 1998." According to the draft report, 86 percent of the losses went to Qwest affiliates, 14 percent to CLECs.

MetroNet disputes the validity of the statements made in the report. MetroNet cites Tatman's deposition testimony that the draft marketing plan was hastily

prepared, based on few hard facts, and never finalized. MetroNet also cites the testimony of Gregory Bogus, its chief operating officer, who stated that the increase in competition after passage of the 1996 Act was confined mainly to the large business telephone market – not the small business market in which MetroNet competes – and that the effect on MetroNet was marginal.

MetroNet contends that the requirements set forth in the 1996 Act and its implementing regulations have not yet become a reality in the state of Washington. MetroNet points out that the 4.2 percent market share of Qwest's competitors is hardly evidence of robust competition. No single competitor has more than one percent of the market for small business local telephone services. In addition, MetroNet's experts claim that various circumstances have kept the central provisions of the 1996 Act from coming to fruition. MetroNet expert Cornell claims that litigation over implementation of the 1996 Act has created a significant ongoing barrier to the realization and use of the rights granted by the act. According to MetroNet expert Kenneth Wilson, Qwest has refused to open its network to local competition on rates, terms and conditions that are just and reasonable, and has refused to provide interconnection at any technically feasible point. He further claims that Qwest has imposed limitations on the use and combination of unbundled elements. According to Wilson, the resale of Centrex is the only area in the market where Qwest faces significant competition.[14] Wilson further

[14] As late as October 2000, resellers continued to sell over 60,000 Centrex lines to small business customers. This constituted 31 percent of the total Centrex market (i.e. all Centrex lines sold to small, medium and large size businesses).

claims that due to Qwest's continued control of the small business local telephone services market, there is no practical alternative to purchasing 1FB or Centrex lines from Qwest, or Centrex lines from resellers like MetroNet.

New Products

Qwest disputes Wilson's claim by arguing that small business customers could also obtain local telephone service by purchasing T-1 lines or DSL lines instead of Centrex or 1FBs. Qwest argues that MetroNet lost customers because it did not offer these and other services. According to MetroNet's marketing manager and former sales manager, MetroNet was losing customers to competitors at least in part because it was not offering products such as DSL lines and T-1 lines. However, MetroNet claims that facility-based CLECs offering these products only serve high-density metropolitan areas and focus on large, not small, business customers.

Qwest also argues that MetroNet lost customers due to the introduction of Centrex 21 in 1997. Centrex 21 was targeted at "small to medium business customers" and was designed "to fill the product continuum gap that currently exists between Basic 1FB service and Centrex Plus." Centrex 21 bundled analog or digital line access with calling features such as call waiting, caller ID and call forwarding. Instead of the Centrex Plus minimum of 21 lines per location, Centrex 21 had a 3 lines per location minimum, up to 50 lines total. Thus, Centrex 21 offered small business customers direct discounts on what was essentially a non-per location basis.

Regulation by the WUTC

As a provider of telecommunications services in the state of Washington, Qwest is subject to regulation by the WUTC. The WUTC is authorized to regulate in the public interest the rates, services, facilities and practices of Qwest and other telecommunications companies. Wash. Rev.Code § 80.01.040(3). Qwest's rates must be "fair, just, reasonable and sufficient," and its service must be "rendered and performed in a prompt, expeditious and efficient manner." *Id.* § 80.36.080.

Qwest must file its tariff schedules with the WUTC, and is prohibited from changing a tariff unless it gives 30 days notice to the WUTC and the public. The WUTC can suspend the proposed changes within the 30 day period, or at any time before they are due to go into effect. *Id.* § 80.36.110(1). Qwest may file a tariff that decreases any rate with 10 days notice without receiving a special order from the WUTC, if the filing does not contain a compensating increase in any rate and if the company agrees for a period of one year not to seek an increase in any rate to recover for revenue lost as a result of the decrease. *Id.* § 80.36.110(2).

The WUTC may on its own initiative or upon complaint hold a hearing to determine whether the rates being charged are "unjust, unreasonable, unjustly discriminatory or unduly preferential, or in anywise in violation of law," or "are insufficient to yield reasonable compensation for the service rendered." *Id.* §§ 34.05.413, 80.36.140. If the WUTC finds in the affirmative, it may impose just and reasonable rates. *Id.* § 80.36.140.

The WUTC has the power to classify a telecommunications company's services as competitive if the service is

subject to effective competition. The prices for competitive services must cover their costs. The WUTC does not have the power to investigate prices for competitive services on its own motion, but it may investigate them upon complaint. *Id.* § 80.36.330(4). Changes in the price of competitive services can become effective 10 days after the list is submitted to the WUTC. *Id.* § 80.36.330(2).

The prices Qwest charges for 1FB lines and for the access component of Centrex are regulated by the WUTC. The price of the features component of Centrex, however, is not, because the WUTC has deemed features a competitive service. MetroNet contends that Qwest exercises effective control over the price for Centrex access despite WUTC regulation, and that Qwest has the ability to exclude competitors such as MetroNet. MetroNet's expert Cornell claims that Qwest effectively has wide latitude in pricing the access component of Centrex because of the WUTC's limited statutory authority, its limited resources and the constraints of the regulatory process. She contends that the WUTC's inability to suspend a proposed price decrease unless that decrease is also accompanied by an offsetting price increase means that Qwest can decrease the price of Centrex access at will. In addition, Qwest can effectively raise the price of access by raising the price of the bundled but unregulated features component.

The Drop in 1FB Rates

Prior to February 1998, the regulated price of a 1FB line was much greater than the regulated price of a volume discounted Centrex line. It is this disparity in rates that created the business opportunity for resellers

like MetroNet. However, in February 1998, the WUTC ordered Qwest to reduce its rates for 1FB lines by more than 31 percent (from $38.10 to $28.60). Shortly thereafter, Qwest also lowered the rate for Centrex access. MetroNet's Marketing Plan 2000 described these rate reductions as the "greatest blow" suffered by MetroNet. According to MetroNet sales manager Beckett, the drop in 1FB rates was a much more significant blow to MetroNet's business than was the entry of competitors. After the sharp reduction in 1FB rates, the number of Centrex lines resold by MetroNet began to decline and the entire sales department resigned.

The Settlement Agreement

Because MetroNet appeals the district court's denial of MetroNet's motion to enforce its purported settlement agreement with Qwest, we set out the facts relevant to the ruling on MetroNet's motion. About nine months after MetroNet filed its antitrust case against Qwest, the two parties met to settle the case. The settlement meetings took place on September 26 and October 3, 2000. Qwest was represented by Lisa Anderl, its in-house counsel, and Don Taylor, the senior account manager responsible for the MetroNet account. MetroNet was represented by its Chief Operating Officer Greg Bogus and by outside counsel Brooks Harlow. After a day and a half of negotiations, the parties were still far apart on the amount of the proposed settlement.

Anderl and Harlow met separately on the afternoon of October 3 and agreed to seek approval from their respective principals for a settlement in the amount of $2.55 million. Harlow called Anderl later that day stating that

he had authority from MetroNet to settle for that amount. Anderl informed him on October 3 or 4 that she also had authority to settle for $2.55 million. Over the next two days, Anderl and Harlow exchanged several drafts of the proposed settlement agreement. Harlow claims that he and Anderl agreed on the final wording of the agreement late on October 5th, and that Anderl told him she had received the necessary approvals from various vice presidents at Qwest. According to Harlow, he and Anderl represented to each other that they had all necessary authority and would be able to obtain signatures on Friday morning, October 6th.

When Harlow called Anderl on Friday morning, however, Anderl informed him she was uncertain she could get the necessary signatures from Qwest. Anderl reiterated this uncertainty on October 9th, and on October 10th she informed Harlow that Qwest's general counsel had decided not to settle the case.

Harlow claims that in his prior negotiations with Anderl over other litigation matters and business agreements, Anderl had either acted on her own authority or had made a deal after speaking with an officer of U S West. Qwest claims that following its merger with U S West on June 30, 2000, it implemented a new policy for Qwest and its subsidiaries designating certain officers as the sole authorized signatories able to bind the company or a subsidiary. According to Qwest General Counsel Tempest, "[a]t no time did any of the designated signatories authorized to bind the Qwest Corporation approve the purported settlement agreement [between Qwest and MetroNet]."

Procedural History

MetroNet filed suit against Qwest on January 5, 2000, seeking money damages and injunctive relief for alleged violations of Section 2 of the Sherman Act.[15] MetroNet asserted three causes of action under Section 2. First, MetroNet claimed Qwest maintained a monopoly over the market for small business local phone services in the Seattle/Tacoma area. Second, MetroNet claimed Qwest attempted to monopolize that market. Third, MetroNet claimed Qwest denied MetroNet access to an essential facility.

On September 26 and October 3, 2000, MetroNet and Qwest met to attempt to settle the case. Qwest withdrew from the proposed settlement agreement on October 10, 2000, and two days later MetroNet moved for an order enforcing the settlement agreement. The district court denied the motion on October 20, 2000, and denied MetroNet's motion to reconsider on November 13, 2000.

Qwest moved for summary judgment on February 13, 2001, and the district court granted Qwest's motion in its entirety on April 16, 2001. MetroNet now appeals the grant of summary judgment and the denial of its motion to enforce the settlement agreement.[16]

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[15] MetroNet also asserted a state law cause of action for breach of contract and the implied covenant of good faith and fair dealing. This cause of action was dismissed without prejudice by the district court on May 2, 2000.

[16] In its opening and reply briefs on appeal, MetroNet has neither challenged, nor even mentioned, the district court's grant of summary judgment against MetroNet on its attempted monopolization claim. As a result, MetroNet has waived this issue on appeal. *See Paracor Fin. Inc. v. Gen. Elec. Capital Corp.*, 96 F.3d 1151, 1168 (9th Cir.1996)

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ANALYSIS

I. Federal Antitrust Claims

A. Standard of Review

We review de novo a district court's grant of summary judgment. *Balint v. Carson City,* 180 F.3d 1047, 1050 (9th Cir.1999) (en banc). We must determine, viewing the evidence in the light most favorable to the nonmoving party, whether there exist any genuine issues of material fact and whether the district court correctly applied the substantive law. *Id.* We may not weigh the evidence or determine the truth of the matter; rather, we may determine only whether there is a genuine issue for trial. *Id.* at 1054.

Although we have noted a number of times in the past that "[s]ummary judgment is disfavored in antitrust cases," *High Tech. Careers v. San Jose Mercury News,* 996 F.2d 987, 989 (9th Cir.1993), such disfavor is limited to "complex antitrust litigation where motive and intent are important, proof is largely in the hands of the alleged conspirators, and relevant information is controlled by hostile witnesses." *Toscano v. Prof'l Golfers Ass'n,* 258 F.3d 978, 982 (9th Cir.2001).[17] As the district court rightly

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(holding that issues not raised and argued in a party's opening brief are waived).

[17] Although some of our cases, such as *High Tech. Careers,* may appear to stand for the proposition that summary judgment is disfavored in all antitrust cases, we have never expressly held that the disfavor extends beyond cases in which motive and intent are centrally in issue. Our oft repeated statement that "[s]ummary judgment is disfavored in antitrust cases" can always be traced back to the Supreme Court's statement in *Poller v. Columbia Broad. Sys., Inc.,* 368 U.S. 464, 82 S.Ct. 486, 7 L.Ed.2d 458 (1962), that "summary procedures should be used sparingly in complex antitrust litigation where motive and

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concluded, this is not such a case. We therefore decline to place a thumb on the scale against granting summary judgment.

B. Implied Immunity

Qwest contends for the first time on appeal that the 1996 Act preempts MetroNet's antitrust claims. Ordinarily, we will not consider legal theories made for the first time on appeal. *Harden v. Roadway Package Sys., Inc.*, 249 F.3d 1137, 1141 (9th Cir.2001). Subject matter jurisdiction, however, is not waivable and therefore may be challenged at any time. *Miguel v. Country Funding Corp.*, 309 F.3d 1161, 1163-64 (9th Cir.2002). The question thus arises whether implied immunity is jurisdictional in nature or whether it is better understood as an affirmative defense subject to waiver. The parties have not briefed this issue and we need not decide it: Qwest's implied immunity argument fails regardless of whether implied immunity is jurisdictional or an affirmative defense.

The Second Circuit recently held that implied antitrust immunity is an affirmative defense subject to waiver and as such "does not affect the court's subject matter jurisdiction over the action." *In re Stock Exchs. Options Trading Antitrust Litig.*, 317 F.3d 134, 150 (2d Cir.2003). If

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intent play leading roles, the proof is largely in the hands of the alleged conspirators, and hostile witnesses thicken the plot." *Id.* at 473, 82 S.Ct. 486. In *High Tech. Careers*, for example, we cited *Christofferson Dairy, Inc. v. MMM Sales, Inc.*, 849 F.2d 1168 (9th Cir.1988), for the proposition that "[s]ummary judgment is disfavored in antitrust cases." *High Tech. Careers*, 996 F.2d at 989. *Christofferson* relied on *Dimidowich v. Bell & Howell*, 803 F.2d 1473 (9th Cir.1986), *see Christofferson*, 849 F.2d at 1171, which in turn relied on *Poller. See Dimidowich*, 803 F.2d at 1477.

that view of implied immunity is correct, then Qwest has waived its implied immunity argument.

The Supreme Court, however, has suggested that implied immunity deprives a court of subject matter jurisdiction because it vests exclusive preliminary jurisdiction in the relevant regulatory agency. *See, e.g., United States Navigation Co. v. Cunard S.S. Co.*, 284 U.S. 474, 485, 52 S.Ct. 247, 76 L.Ed. 408 (1932) (holding that the Shipping Act supersedes the antitrust laws and vests the Shipping Board with "exclusive preliminary jurisdiction"); *see also United States v. Nat'l Ass'n of Sec. Dealers, Inc.*, 422 U.S. 694, 734-35, 95 S.Ct. 2427, 45 L.Ed.2d 486 (1975) ("[W]e have implied immunity in particular and discrete instances to assure that the federal agency entrusted with regulation in the public interest could carry out that responsibility free from the disruption of conflicting judgments that might be voiced by courts *exercising jurisdiction under the antitrust laws.*") (emphasis added). On this view, the issue of implied immunity has not been waived and is properly before us.

Even if we assume *arguendo* that Qwest's implied immunity argument has not been waived, it fails nonetheless. Qwest relies on *Goldwasser v. Ameritech Corp.*, 222 F.3d 390 (7th Cir.2000), in which the court held that "[t]he 1996 Act is . . . more specific legislation that must take precedence over the general antitrust laws, where the two are covering precisely the same field." *Id.* at 401.[18] Two

[18] The *Goldwasser* court stated that "Our principal holding is . . . not that the 1996 Act confers implied immunity on behavior that would otherwise violate the antitrust law. Such a conclusion would be troublesome at best given the antitrust savings clause in the statute." *Id.* at 401. However, the court *in effect* held that defendants are

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other circuit courts have expressly disagreed with *Goldwasser*, concluding that the 1996 Act did not confer implied immunity from suit under the antitrust laws. *See Law Offices of Curtis V. Trinko v. Bell Atl. Corp.*, 305 F.3d 89, 109-13 (2d Cir.2002) (as amended), *cert. granted in part sub nom. Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*, ___ U.S. ___, 123 S.Ct. 1480, 155 L.Ed.2d 224 (2003); *Covad Communications Co. v. BellSouth Corp.*, 299 F.3d 1272, 1280-82 (11th Cir.2002). We agree with the Second and Eleventh Circuits that the 1996 Act did not impliedly immunize Qwest from antitrust liability.

The Supreme Court has repeatedly noted that "[r]epeals of the antitrust laws by implication from a regulatory statute are strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions." *Square D Co. v. Niagara Frontier Tariff Bureau, Inc.*, 476 U.S. 409, 421, 106 S.Ct. 1922, 90 L.Ed.2d 413 (1986) (internal quotation marks and citations omitted). The plain language of the statute reveals that Congress intended the 1996 Act to coexist with, rather than preempt, the antitrust laws. "Congress explicitly stated – both through a savings clause directed specifically at antitrust enforcement and through an additional general savings clause – that the 1996 Act does not supplant or change the antitrust laws." *Covad Communications Co.*, 299 F.3d at 1280. The 1996 Act provides:

> ANTITRUST LAWS . . . SAVINGS CLAUSE . . .
> [N]othing in this Act or the amendments made

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impliedly immune from suit under the antitrust laws when the challenged conduct is also covered by the 1996 Act. *Id.*

> by this Act shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws. . . .
>
> FEDERAL STATE AND LOCAL LAW . . . NO IMPLIED EFFECT . . . This Act and the amendments made by this Act shall not be construed to modify, impair, or supersede Federal, State, or local law unless expressly so provided in such Act or Amendments.

Telecommunications Act of 1996, §§ 601(b)(1), (c)(1), 110 Stat. 56, 143 (1996), *codified at* 47 U.S.C. § 152, Historical and Statutory Notes. In light of this express language, we conclude that no "plain repugnancy" exists between the 1996 Act and the antitrust laws. *Law Offices of Curtis v. Trinko,* 305 F.3d at 109 ("The savings clause unambiguously establishes that there is no 'plain repugnancy' between the Telecommunications Act and the antitrust statutes [and thus] that the Telecommunications Act does not provide an 'implicit immunity' from the antitrust laws."); *Covad Communications Co.,* 299 F.3d at 1281 (same).[19]

Even absent the explicit language of the savings clauses, Qwest would not be entitled to implied immunity

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[19] Like the Eleventh Circuit, we conclude "that the plain statutory language is sufficient to end our inquiry on this matter." *Covad Communications Co.,* 299 F.3d at 1281. We also agree with the Eleventh Circuit that "should there be any doubt that the plain language of the savings clause resolves the issue, we find support for our conclusion in the legislative history surrounding the 1996 Act, reflecting that the President, the Congress, the Department of Justice, and the FCC have emphasized the critical need for the antitrust laws to work in conjunction with the 1996 Act in order to spur competition in the telecommunications industry." *Id.*

for its imposition of per location pricing. "Pervasive regulation of an industry alone is insufficient to confer blanket immunity on every action taken within the industry." *Northrop Corp. v. McDonnell Douglas Corp.*, 705 F.2d 1030, 1056 (9th Cir.1983) (citing *Otter Tail Power Co. v. United States*, 410 U.S. 366, 372-75, 93 S.Ct. 1022, 35 L.Ed.2d 359 (1973)).[20] Although we have recognized a limited class of cases in which a regulatory mandate to engage in anticompetitive conduct may confer implied antitrust immunity, no such mandate exists here. *Id.* at 1057. The 1997 switch from system pricing to per location pricing for Centrex features was freely undertaken by Qwest in an effort to eliminate resale. Where the conduct challenged under the antitrust laws "is the product of the regulated business' independent initiative and choice, [that conduct] is properly subject to antitrust scrutiny." *Id.* Thus, Qwest's imposition of per location pricing is not conduct entitled to implied immunity.

C. Discussion

MetroNet contends that the district court overlooked genuine disputes of material fact in ruling that Qwest neither maintained a monopoly nor excluded MetroNet from an essential facility in violation of Section 2 of the Sherman Antitrust Act, 15 U.S.C. § 2. We consider each claim in turn.

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[20] "A regulatory mandate sufficient to confer implied antitrust immunity may in some cases exist where there is explicit congressional approval of the challenged conduct and its ultimate anticompetitive effect, and there is no inconsistency or 'plain repugnancy' between the conduct and the express policies of the regulating body." *Northrop*, 705 F.2d at 1057.

1. The Monopolization Claim

Section 2 of the Sherman Act makes it illegal for a person to "monopolize . . . any part of the trade or commerce among the several States." 15 U.S.C. § 2. Any person "injured in his business or property" by such monopolization may bring suit for treble damages under Section 4 of the Clayton Act, 15 U.S.C. § 15(a). In order to prevail on its monopolization claim, MetroNet must prove that Qwest (1) possessed monopoly power in the relevant market, (2) wilfully acquired or maintained that power through exclusionary conduct and (3) caused antitrust injury. *See Am. Prof'l Testing Serv., Inc. v. Harcourt Brace Jovanovich Legal & Prof'l Publ'ns, Inc.*, 108 F.3d 1147, 1151 (9th Cir.1997). The district court erroneously concluded on summary judgment that MetroNet could not establish any of these elements.

Monopoly power: Monopoly power, commonly referred to as market power, is defined as "'the power to control prices or exclude competition.'" *Image Tech. Servs., Inc. v. Eastman Kodak Co.*, 125 F.3d 1195, 1202 (9th Cir.1997) (quoting *United States v. Grinnell Corp.*, 384 U.S. 563, 571, 86 S.Ct. 1698, 16 L.Ed.2d 778 (1966)). "Market power can be proven by either direct or circumstantial evidence." *Id.* Because direct evidence of the power to control prices or exclude competitors is rarely available, courts generally rely on circumstantial evidence of market power. *United States v. Microsoft Corp.*, 253 F.3d 34, 51 (D.C.Cir.2001). In order to establish Qwest's market power by circumstantial evidence, MetroNet must "(1) define the relevant market, (2) show that the defendant owns a dominant share of that market, and (3) show that there are significant barriers to entry and . . . that existing competitors lack the capacity to

increase their output in the short run." *Rebel Oil, Inc. v. Atl. Richfield Co.*, 51 F.3d 1421, 1434 (9th Cir.1995).

Here, the relevant market is not in dispute. The parties have defined it as the market for small business local telephone services in the Seattle/Tacoma area. Thus we turn directly to the issue of Qwest's market share. The principal competing products in the market are Qwest's 1FB service and the resellers' Centrex service purchased from Qwest and resold to small business users.[21]

The district court concluded that even though Qwest's market share exceeds 95 percent, "it is highly unlikely that Qwest's high market share confers upon it monopoly power." The court reasoned that the 1996 Act had already removed many of the barriers to entry, and any remaining barriers "will diminish in time as new firms build their infrastructure, gain a toehold in the market, advertise more widely, and gain wider recognition." On these assumptions, the court predicted that "a 95 [percent] market share now could well evaporate in the coming years without antitrust involvement."

The district court was equally dismissive of MetroNet's claim that Qwest could control prices. The court reasoned first that "phone service is not the type of commodity that is susceptible to price increase through output reduction." The court also reasoned that competition in the wake of the 1996 Act would limit Qwest's ability to control

[21] The market also includes T-1 and DSL lines sold to small businesses, though the parties dispute the extent to which these products provide small businesses with viable alternatives to 1FB and Centrex lines. The market does not encompass Qwest's sales of Centrex directly to end-users because those end users are large, not small, businesses.

prices for calling features, and that regulation by the WUTC "mitigates the extent to which Qwest can simply dictate prices for access to phone service."

The district court was correct to focus its attention on Qwest's ability to exclude competition and control prices, rather than simply on market share. In general, a plaintiff may establish a prima facie case of market power by showing that the defendant has a 65 percent or greater market share. *Image Tech.*, 125 F.3d at 1206 (citing *Am. Tobacco Co. v. United States*, 328 U.S. 781, 797, 66 S.Ct. 1125, 90 L.Ed. 1575 (1946)). However, in cases involving regulated industries, "[r]eliance on statistical market share . . . is downright folly where, as here, the predominant market share is the result of regulation." *Metro Mobile CTS, Inc. v. NewVector Communications, Inc.*, 892 F.2d 62, 63 (9th Cir.1989); *see also S. Pac. Communications Co. v. AT & T*, 740 F.2d 980, 1000 (D.C.Cir.1984) ("Reliance on statistical market share is a questionable approach in cases involving regulated industries. . . . A predominant market share may merely be the result of regulation, and regulatory control may preclude the exercise of monopoly power."). We have held that "[i]n such cases, the court should focus directly on the regulated firm's ability to control prices or exclude competition." *Metro Mobile*, 892 F.2d at 63; *see also S. Pac. Communications Co.*, 740 F.2d at 1000 (holding that "in such cases market share should be at most a point of departure in determining whether monopoly power exists. Ultimately, a court should focus directly upon the ability of the regulated firm to control prices or exclude competition.").

Although the focus of the district court's inquiry was correct, the court nonetheless improperly weighed evidence and failed to view the facts in the light most favorable to

MetroNet. The court should not have substituted its own speculations about present and future barriers to entry for the evidence in the record. MetroNet's expert Cornell stated in her declaration that there are at least three structural barriers to entry that give Qwest a high degree of market power: (1) each end user of telephone services must be physically connected to a local exchange switch, which makes it prohibitively expensive to build a telephone network from scratch; (2) because Qwest owns the only comprehensive local exchange network, both facilities-based providers and resellers need a high degree of cooperation from Qwest in order to access that network; and (3) Qwest's historical monopoly has created enormous economies of scale that discourage competition and give Qwest an incentive not to cooperate.

The district court concluded, based presumably on MetroNet's year 2000 draft marketing report, that "MetroNet's expert overstates the case for high entry barriers in this market." The draft marketing report, which was prepared by sales manager Beckett and quality assurance manager Tatman, stated that "MetroNet . . . has seen the number of competitive providers go from solely U S West to over 17 in [the] past three years. . . . The flood of competition has produced a never ending push for customers to switch services to a new provider." However, the validity of these statements is contested. Tatman testified on deposition that the draft marketing plan was hastily prepared, based on few hard facts and never finalized. MetroNet COO Bogus testified that the increase in competition after passage of the 1996 Act was confined mainly to the large business telephone market and that the effect on MetroNet was "marginal." The district court improperly

treated the statements in the draft marketing report as though they were undisputed by MetroNet.

Qwest argues that the statements in the draft marketing report are sufficient to "render MetroNet's expert reports to the contrary unreasonable and preclude MetroNet (and Amicus) from arguing that those reports raise a factual dispute." The district court's disregard for the testimony of MetroNet's experts seems premised on the same argument. We have recognized that "expert opinion . . . may defeat summary judgment if it appears that the affiant is competent to give an expert opinion and that the factual basis for the opinion is stated in the affidavit, even though the underlying factual details and reasoning upon which the opinion is based are not." *Rebel Oil,* 51 F.3d at 1435. However, "the inference to be drawn from expert affidavits must . . . be sufficient to support a favorable jury verdict." *Id.* "'When an expert opinion is not supported by sufficient facts to validate it in the eyes of the law, or when indisputable record facts contradict or otherwise render the opinion unreasonable, it cannot support a jury's verdict.'" *Id.* at 1436 (quoting *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.,* 509 U.S. 209, 242, 113 S.Ct. 2578, 125 L.Ed.2d 168 (1993)). Thus, in antitrust cases, inferences drawn from expert opinions must be economically reasonable in light of "undisputed facts about the structure of the market." *Id.* at 1435-36. There is no basis in the record for concluding that the testimony of MetroNet's experts fails to meet the standard articulated in *Rebel Oil.* It was improper for the district court to disregard the opinions of MetroNet's experts without providing a reasoned analysis of how their opinions failed to satisfy the *Rebel Oil* standard.

The court also erred in concluding that Qwest could not control price due to competition in the market for features and WUTC regulation of the price of [illegible]trex access. The court inferred from MetroNet's year 2000 draft marketing report that at least 17 competitors had entered the local small business telephone services market in Seattle/Tacoma. As we point out above, however, the draft marketing report cannot be accepted as undisputed evidence. MetroNet has raised a triable issue of fact as to the number and extent of new entrants.

Even if the draft marketing report were accepted as true, "[t]he fact that entry has occurred does not necessarily preclude the existence of 'significant' entry barriers." *Rebel Oil,* 51 F.3d at 1440. We have previously concluded on several occasions that monopoly power exists despite the presence of new entrants. *Id.* at 1441 (holding, on appeal from summary judgment, that a juror could reasonably conclude that the entry of two gas stations into the Las Vegas retail gasoline market would be insufficient to offset supracompetitive prices); *Oahu Gas Serv., Inc. v. Pac. Res., Inc.,* 838 F.2d 360, 367 (9th Cir.1988) (holding, on appeal of a motion for judgment notwithstanding the verdict, that the entry of two rivals did not preclude the jury's finding of monopoly power); *Pac. Coast Agric. Exp. Assoc. v. Sunkist Growers, Inc.,* 526 F.2d 1196, 1204 (9th Cir.1975) (holding that Sunkist had monopoly power over the Hong Kong export market for Arizona-and California-grown oranges, where its competitors "were relatively small, with no single competitor controlling over . . . 12% of the market after [] Sunkist's entry."). In the present case, recent entrants collectively account for less than five percent of the market, and no single entrant has more than a one percent share. Qwest asks us to infer from this

anemic market share that the opinions of MetroNet's experts on barriers to entry are unreasonable. We decline to do so. There is no evidence that these entrants will continue to wrest market share from Qwest.

In concluding that the WUTC could effectively constrain Qwest's ability to control the price of telephone access, the district court failed to consider the realities of Washington's regulatory scheme. *See S. Pac. Communications,* 740 F.2d at 1001 (setting aside the district court's conclusion on summary judgment that AT & T lacked monopoly power because the district court "fail[ed] to consider the realities of the regulatory scheme. . . . The regulatory agencies are not always able to respond to the alleged abuses immediately and effectively."). MetroNet proffered evidence that the WUTC's limited statutory authority, limited resources and the constraints of the regulatory process effectively left Qwest with considerable latitude in setting the price for Centrex ac . MetroNet also proffered evidence that for the last 15 years Qwest has been able to evade the WUTC's instructions to unbundle Centrex access from Centrex features.

The key question is whether existing competitors and immediate potential entrants have sufficient capacity to take business away from the incumbent monopolist and thereby constrain the incumbent's ability to raise prices above competitive levels. *See Rebel Oil,* 51 F.3d at 1440-41; *see also Microsoft,* 253 F.3d at 51. MetroNet has proffered sufficient evidence on the continuing barriers to entry to create a triable issue of fact as to the ability of new and existing entrants to constrain Qwest's market power.

Exclusionary conduct: The mere existence of monopoly power does not constitute illegal monopolization under

Section 2 of the Sherman Act. A plaintiff must also establish that the defendant acquired or maintained the monopoly by engaging in exclusionary conduct "as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *Grinnell,* 384 U.S. at 571, 86 S.Ct. 1698. "[T]o be condemned as exclusionary, a monopolist's act must have an 'anticompetitive effect.' That is, it must harm the competitive *process* and thereby harm consumers. . . . [H]arm to one or more *competitors* will not suffice." *Microsoft,* 253 F.3d at 58 (emphasis in original). This focus on an anticompetitive effect is essential, because "it is inimical to the antitrust laws to award damages for losses stemming from acts that do not hurt competition." *Rebel Oil,* 51 F.3d at 1433. Thus, courts must seek to distinguish between exclusionary conduct that harms consumer welfare and legitimate competitive acts that enhance it. *Microsoft,* 253 F.3d at 58. We have held that "[c]onsumer welfare is maximized when economic resources are allocated to their best use. . . . and when consumers are assured competitive price and quality." *Rebel Oil,* 51 F.3d at 1433. "[A]n act is deemed *anticompetitive* under the Sherman Act only when it harms both allocative efficiency *and* raises the prices of goods above competitive levels or diminishes their quality." *Id.* (emphasis in original).

In assessing whether Qwest's imposition of per location pricing has harmed consumer welfare, we are mindful that the antitrust laws protect competition, not particular competitors. We do not suggest that a provider of services must maintain in existence middlemen who deliver no economic value to consumers. MetroNet's allegation, rather, is that resellers enhance consumer welfare by providing small business consumers with lower-price

telecommunications services, and that Qwest is seeking to eliminate this contribution to consumer welfare through per location pricing.

The district court concluded that MetroNet could not establish harm to consumer welfare because market competition prevented Qwest from raising the overall price for Centrex above competitive levels. The court reached this conclusion based on evidence that the overall price of Centrex to consumers dropped significantly. Qwest argues similarly on appeal that the decline in the overall price of Centrex precludes a finding that Qwest raised prices above competitive levels.

We must determine whether MetroNet has created a triable issue of fact as to whether per location pricing harmed consumer welfare. Both the district court and Qwest erroneously focus on the overall price of Centrex.[22] It is undisputed that when Qwest instituted per location pricing the price of Centrex features for customers with fewer than 21 lines went up approximately 400 percent,

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[22] That Qwest requires customers to purchase access and features together does not in turn require that we look at the bundled, rather than the unbundled, price of Centrex components in assessing harm to consumer welfare. Even if the fall in the price of access more than offset a rise in the price of features, thereby causing the overall price of Centrex to fall, Qwest could still be held liable for anticompetitive pricing on the features component. The question is whether the price of features, and therefore Centrex overall, would be *even lower* were it not for per location pricing.

Qwest asserts that its pricing of calling features does not raise antitrust concerns because the pricing of features is unregulated. The mere fact that the price of features is unregulated, however, does not negate the undisputed evidence that Qwest's imposition of per location pricing raised the price of features far above cost for small business customers.

and that it was almost six times greater than the price charged to medium and large businesses. This is prima facie evidence of pricing above competitive levels.

MetroNet also proferred evidence that the elimination of resellers would harm allocative efficiency. According to Cornell, resale performs the beneficial function of "forc[ing] the firm whose services are being resold to limit volume discounts to levels that are cost-based. Without resale, the firm might be able to offer volume discounts that were greater than the costs saved and recover the lost revenues from smaller users." MetroNet contends, and Qwest has not denied, that there is no cost-based or volume-based justification for per location pricing. Courts have recognized that discount resellers such as MetroNet can play an important role in creating and maintaining a competitive marketplace and have held that attempts to eliminate discounters violate the antitrust laws. *Cf. United States v. Gen. Motors Corp.*, 384 U.S. 127, 146-47, 86 S.Ct. 1321, 16 L.Ed.2d 415 (1966) (holding that a conspiracy among GM, automobile dealers and their association to deprive franchised dealers of the freedom to sell through discounters was unlawful conspiracy in restraint of trade under Section 1 of the Sherman Act); *Toys "R" Us, Inc. v. FTC,* 221 F.3d 928, 935-37 (7th Cir.2000) (upholding an FTC decision that a conspiracy between Toys "R" Us and toy manufacturers to restrict manufacturers' sales to low price warehouse club stores violated the antitrust laws).

There would be no harm to consumer welfare if customers could switch to a virtually identical product costing the same or less than Centrex without per location pricing. Thus, if customers could purchase 1FB lines and features for approximately the same price they would pay

for Centrex access and features without per location pricing, MetroNet would have no claim. But the record suggests the contrary: the price of 1FB lines *without features* remained significantly above the price of Centrex, even after the WUTC-imposed drop in the price of 1FB lines in February 1998. The record suggests that small business consumers had little or no economically equivalent alternative but to continue purchasing Centrex access and features from resellers such as MetroNet. If true, the increase in the price of Centrex features above competitive levels harmed consumers.[23]

Given that MetroNet has successfully made out a prima facie case of exclusionary conduct by demonstrating anticompetitive effect, the burden shifts to Qwest to offer a procompetitive justification for per location pricing. *See Microsoft*, 253 F.3d at 59.

> If the monopolist asserts a procompetitive justification – a nonpretextual claim that its conduct is indeed a form of competition on the merits because it involves, for example, greater efficiency or enhanced consumer appeal – then the burden shifts back to the plaintiff to rebut that claim. . . . [I]f the monopolist's procompetitive justification stands unrebutted, then the plaintiff must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit.

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[23] The lack of an effective substitute is also borne out by the fact that as late as October 2000, resellers continued to sell more than 60,000 Centrex lines to small business customers. This constituted 31 percent of the total Centrex market (i.e. all Centrex lines sold to small, medium and large businesses).

Id. Qwest has not asserted any procompetitive justification for per location pricing. It is undisputed that per location pricing has no cost-based justification, *compare Oahu Gas,* 838 F.2d at 368 (economic necessity justified allegedly exclusionary conduct), and Qwest has not suggested how per location pricing enhances efficiency or improves the products offered to consumers, *see Microsoft,* 253 F.3d at 59.[24] Therefore, MetroNet has proffered sufficient evidence to establish exclusionary conduct on the part of Qwest.

Antitrust injury: A private party seeking damages under Section 2 must also establish that the defendant caused it anti-trust injury. Based on its determination that MetroNet failed to raise a triable issue of fact as to Qwest's alleged monopoly power or exclusionary conduct, the district court summarily concluded that MetroNet could not establish that it suffered an antitrust injury. Because we have reached the opposite conclusion with respect to Qwest's alleged monopoly power and exclusionary conduct, we address the merits of the antitrust injury requirement.

To satisfy this requirement, the plaintiff must show (1) that it suffered an injury in fact, (2) that the injury was caused by an antitrust violation and (3) that the injury was of the type the antitrust laws were intended to prevent. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.,* 429 U.S. 477, 489, 97 S.Ct. 690, 50 L.Ed.2d 701 (1977); *see also*

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[24] It is also undisputed that Qwest imposed per location pricing in order to eliminate the resale market for Centrex Plus. However, we note that evidence of intent behind Qwest's conduct is relevant only to the extent that it helps us understand the likely effect of Qwest's conduct. *Microsoft,* 253 F.3d at 59.

Rebel Oil, 51 F.3d at 1433. Qwest contends that MetroNet has failed to establish any of these elements. We consider each of them in turn.

First, Qwest argues that MetroNet has failed to establish that it suffered injury in fact. MetroNet's CEO Seeley claims MetroNet began losing money in 1997 and suffered a net loss in 1999 and 2000. However, MetroNet's bookkeeper testified on deposition that MetroNet was profitable in 1999. Although the evidence of the financial harm to MetroNet is weak, it is sufficient to withstand summary judgment. Even if MetroNet remained profitable in 1999, the testimony of its CEO indicates an increasing loss of revenue and profits. A showing of harm under Section 2 of the Sherman Act does not require that the plaintiff go bankrupt or experience a net loss. A decline in anticipated profits will suffice. *See, e.g., Blanton v. Mobil Oil Corp.,* 721 F.2d 1207, 1215 (9th Cir.1983) ("To establish causal antitrust injury, 'the plaintiff is required to establish with reasonable probability the existence of some causal connection between defendant's wrongful act and *some loss of anticipated revenue.*'" (emphasis added)); *see also Zenith Radio Corp. v. Hazeltine Research, Inc.,* 395 U.S. 100, 114 n. 9, 89 S.Ct. 1562, 23 L.Ed.2d 129 (1969) ("[The plaintiff's] burden of proving the fact of damage under [Section] 4 of the Clayton Act is satisfied by its proof of *some* damage flowing from the unlawful conspiracy; inquiry beyond this minimum point goes only to the amount and not the fact of damage." (emphasis in original)). Furthermore, "[w]here, as here, defendants have acted with intent to eliminate competition, the proof of resulting injury need not be overwhelming." *D & S Redi-Mix v. Sierra Redi-Mix & Contracting Co.,* 692 F.2d 1245, 1249 (9th Cir.1982); *see also Fox West Coast Theatres Corp.*

v. Paradise Theatre Bldg. Corp., 264 F.2d 602, 608 (9th Cir.1958) ("[The fact of] damage need not be made patent item by item as on a balance sheet. The mere unlawful combination over a period of time to eliminate competition is proof of damage.").

Second, Qwest contends that even if MetroNet has established injury in fact, it has not established causation because any decline in MetroNet's profitability was due not to per location pricing, but rather to the entry of new competitors after passage of the 1996 Act, the precipitous drop in 1FB rates imposed by the WUTC in 1998, the advent of competing modes of access such as T-1 and DSL and heavy personnel turnover at MetroNet.

To establish causation, MetroNet need only show that per location pricing was a "material cause" of MetroNet's injury. *See Zenith Radio Corp.*, 395 U.S. at 114 n. 9, 89 S.Ct. 1562 ("It is enough that the illegality is shown to be a material cause of the injury; a plaintiff need not exhaust all possible alternative sources of injury in fulfilling his burden of proving compensable injury. . . ."). We have interpreted this to mean that the plaintiff must "establish with reasonable probability the existence of some causal connection between defendant's wrongful act and some loss of anticipated revenue." *Blanton*, 721 F.2d at 1215 (internal quotation marks omitted). MetroNet must therefore show that "the antitrust violation contribute[d] significantly to [its] injury, even if other factors amounted in the aggregate to a more substantial cause." 2 Areeda & Hovenkamp, Antitrust Law § 338a, at 317 (2d ed.2000) (interpreting *Zenith*). However, MetroNet's claim fails as a matter of law if MetroNet would have suffered the same injury even without per location pricing. *See Brunswick Corp.*, 429 U.S. at 487-88, 97 S.Ct. 690; *see also* 2 Areeda

& Hovenkamp § 338b, at 320-21 (noting that no material cause can be demonstrated where an independent cause fully accounts for the claimed antitrust injury).

The other possible causes of MetroNet's woes do not negate MetroNet's evidence that per location pricing played a material role in causing its injury. Therefore, MetroNet has proffered sufficient evidence to create a triable issue of fact as to causation.

Finally, Qwest contends that MetroNet has failed to show that its injury is the type of injury the antitrust laws were designed to prevent, such that Qwest's conduct has harmed consumer welfare. A showing of such injury is distinct from the question of causation. *Brunswick,* 429 U.S. at 487-89, 97 S.Ct. 690 (noting that antitrust violations can cause "losses which are of no concern to the antitrust laws" and that "plaintiffs . . . must prove more than injury causally linked to an illegal presence in the market").

The antitrust laws are intended to protect competition, not competitors. *Brown Shoe Co. v. United States,* 370 U.S. 294, 320, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962). "To show antitrust injury, a plaintiff must prove that his loss flows from an anticompetitive aspect or effect of the defendant's behavior. . . . If the injury flows from aspects of the defendant's conduct that are beneficial or neutral to competition, there is no antitrust injury. . . ." *Rebel Oil,* 51 F.3d at 1433. Where the defendant's illegal conduct harms the plaintiff without adversely affecting competition generally, we have found no antitrust injury. *See, e.g., Pool Water Prods. v. Olin Corp.,* 258 F.3d 1024, 1034-36 (9th Cir.2001).

MetroNet's CEO Seeley claims MetroNet's financial losses flowed from Qwest's imposition of per location pricing. It appears that some customers left MetroNet at least in part because of the higher price for features, although this point is disputed, and that MetroNet increasingly found itself unable to make a profit on the customers who remained. We have already concluded that MetroNet has proffered sufficient evidence of an anticompetitive effect to establish exclusionary conduct. We further conclude that, for purposes of avoiding summary judgment, MetroNet has proffered sufficient evidence to establish that its injury flowed from the anticompetitive effects of per location pricing.

We hold that at this stage in the litigation MetroNet has adduced sufficient evidence of monopoly power, exclusionary conduct and antitrust injury to proceed with its monopolization claim.

2. The Essential Facilities Claim

"The 'essential facilities' doctrine imposes on the owner of a facility that cannot reasonably be duplicated and which is essential to competition in a given market a duty to make that facility available to its competitors on a nondiscriminatory basis." *Ferguson v. Greater Pocatello Chamber of Commerce, Inc.,* 848 F.2d 976, 983 (9th Cir.1988). The origin of the doctrine is generally traced to *United States v. Terminal R.R. Ass'n,* 224 U.S. 383, 32 S.Ct. 507, 56 L.Ed. 810 (1912), in which the Supreme Court held that the defendants, railroad companies that jointly owned all rail terminal facilities across the Mississippi at St. Louis, could not deny their competitors access to those facilities on reasonable terms because such access

was essential to competition. A denial of access to an essential facility violates Section 2 because control of an essential facility can "extend monopoly power from one stage of production to another, and from one market into another." *MCI Communications Corp. v. AT&T Co.*, 708 F.2d 1081, 1132 (7th Cir.1983).

In order to prevail on its essential facilities claim, MetroNet must prove (1) that Qwest is a monopolist in control of an essential facility, (2) that MetroNet, as Qwest's competitor, is unable reasonably or practically to duplicate the facility,[25] (3) that Qwest has refused to provide MetroNet access to the facility and (4) that it is feasible for Qwest to provide such access.[26] *See City of Anaheim v. S. Cal. Edison Co.*, 955 F.2d 1373, 1380 (9th Cir.1992) (citing *MCI Communications Corp.*, 708 F.2d at 1132-33). The district court found that MetroNet could not prove any of the first three elements.[27] We disagree.

Under the first element, "[a] facility that is controlled by a single firm will be considered 'essential' only if control of the facility carries with it the power to *eliminate* competition in the downstream market." *Alaska Airlines, Inc. v.*

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[25] We have "point[ed] out that the second element is effectively part of the definition of what is an essential facility in the first place. That is to say, if the facility can be reasonably or practically duplicated it is highly unlikely, even impossible, that it will be found to be essential at all." *City of Anaheim v. S. Cal. Edison Co.*, 955 F.2d 1373, 1380 (9th Cir.1992).

[26] We have "pointed out that the fourth element basically raises the familiar question of whether there is a legitimate business justification for the refusal to provide the facility." *City of Anaheim*, 955 F.2d at 1380.

[27] The parties do not dispute that MetroNet can satisfy the fourth element of its essential facilities claim.

United Airlines, Inc., 948 F.2d 536, 544 (9th Cir. 1991). The alleged essential facility in this case is Qwest's comprehensive local exchange network. Resellers obtain access to that network through the Centrex product. Thus, the claim is that Qwest has denied resellers like MetroNet access to its network by effectively eliminating the market for Centrex resale.

The district court concluded that MetroNet could not establish Qwest's control of this facility because the 1996 Act requires Qwest to provide competitors with interconnection and with access to calling features. Responding to MetroNet's argument that Qwest's exclusionary pricing prevented MetroNet from reasonable access to Qwest's local exchange network, the district court concluded:

> Even if the per location pricing policy makes the calling features available to MetroNet and other firms on terms that make resale of those features unprofitable, there will still be competition in the market for local business phone service from wholesalers and from firms with their own facilities who have interconnected with Qwest's physical network under the Telecom Act.

This conclusion – although perhaps plausible – is not supported by the record. MetroNet's draft marketing report and the depositions of Tatman and Beckett, when viewed in the light most favorable to MetroNet, do not support an inference of effective or sustained competition. Furthermore, MetroNet's experts Wilson and Cornell stated in their reports that Qwest did not face effective competition. Wilson stated that "there are no practical alternatives for service for small businesses other than [Qwest] provided service or service provided by Centrex resale such as that provided by MetroNet." In light of the

record on summary judgment, the district court erred in assuming, to MetroNet's detriment, that the passage of the 1996 Act in fact caused Qwest to "open access to at least part of its essential facility."[28]

With respect to the second element, MetroNet must show its inability practically or reasonably to duplicate the facility. The district court concluded that MetroNet could not establish a lack of reasonable alternative means of access to Qwest's essential facility. The court found that competitors could gain access to Qwest's facility by purchasing 1FB lines and certain calling features from Qwest at wholesale prices and reselling them for a profit. The court also found that MetroNet had failed to rebut evidence that features could be purchased on the open market at competitive prices. The record does not support either conclusion.

There is no evidence that 1FB lines can be purchased at wholesale prices and resold profitably, and MetroNet, which bears the burden of proof, adduced evidence to the

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[28] Pursuant to the interconnection provisions of the 1996 Act, MetroNet signed an interconnection agreement with Qwest in August 2000. MetroNet, however, has not made use of that agreement. Qwest argues on appeal that the interconnection agreement proves that Qwest lacks control over an essential facility and that even if Qwest does have such control, it has not denied access to MetroNet. MetroNet's CEO Seeley stated in his declaration, however, that "the wholesale interconnection agreement option was not a realistic option at all." According to Seeley, Qwest refused to include long-distance and voice mail services in the agreement, which meant that end users would have to move to another service provider. As a result, according to Seeley, MetroNet would lose 30 to 40 percent of its business. The mere fact that MetroNet signed an interconnection agreement does not negate MetroNet's evidence that Qwest controls an essential facility and that it denied MetroNet reasonable access to that facility.

contrary. MetroNet expert Cornell stated: "[t]here is no evidence in this case that . . . MetroNet could turn to other providers for the essential inputs to provide services to small business users." MetroNet's CEO stated that the resale of 1FB lines is "an illusion," and that "if we resold 1FBs we would be insolvent immediately." He did not provide an explanation for these statements, but the reasonable inference on summary judgment is that the difference between the wholesale and resale prices of 1FB lines is not enough for MetroNet to make a profit through resale. This inference is supported by MetroNet expert Wilson's statement that the wholesale discount on business lines is too small to encourage competition. If 1FB lines could not be resold profitably, the question whether MetroNet could purchase features on the open market at competitive prices is not dispositive. Although MetroNet's COO Bogus testified on deposition that MetroNet could purchase voice mail from vendors other than Qwest, there is no evidence that MetroNet could do so profitably. There is also no evidence that MetroNet could purchase features from Qwest without also purchasing Centrex access.

The third element of MetroNet's essential facilities claim requires a showing that Qwest denied MetroNet access to the facility. Access need not be denied absolutely; unreasonable terms and conditions of access, such as the services provided or the rates charged, may result in practical denial of access. *See, e.g., Laurel Sand & Gravel, Inc. v. CSX Transp., Inc.*, 924 F.2d 539, 544-45 (4th Cir.1991); *Del. & Hudson Ry. Co. v. Consol. Rail Corp.*, 902 F.2d 174, 180 (2d Cir.1990). However, providing access at a fee that is not so high as to drive away competition does not amount to a denial of access. *Alaska Airlines*, 948 F.2d at 545-46. *See also Ideal Dairy Farms, Inc. v. John Labatt,*

Ltd., 90 F.3d 737, 748 (3d Cir.1996). The district court, citing *Alaska Airlines,* correctly stated the test as follows: "Qwest would deny MetroNet access to its essential facility if it simply refuse[d] MetroNet any access to its facility, or price[d] access to that facility in a way that would 'drive [MetroNet] away.'" MetroNet does not claim that Qwest has denied it all access; rather, MetroNet claims that per location pricing had the effect of driving it out of the market.

The district court required MetroNet to show (1) that per location pricing made MetroNet's resale of Centrex unprofitable and (2) that "*any* unprofitability was caused *solely* by Qwest's pricing policy." (Emphasis added.) The first requirement is largely correct; the second overstates MetroNet's burden. As to the first requirement, it is not enough for MetroNet to show that per location pricing merely decreased its profitability; MetroNet must show that the decrease in profitability due to per location pricing was significant enough to discourage MetroNet from staying in the business. In other words, MetroNet must show that per location pricing made the Centrex resale business unprofitable, or squeezed the profit margin to the point where the game was no longer worth the candle. As to the second requirement, MetroNet need not prove that all of its financial woes were caused by per location pricing; rather, it must show that the financial harm attributable to per location pricing – apart from the financial harm due to other causes – was alone sufficient to drive it out of the market. *See Alaska Airlines,* 948 F.2d at 545-46.

MetroNet's only evidence in support of its claim that per location pricing had the effect of driving it and other resellers away is the declaration of its CEO. Seeley claims

that as a direct result of per location pricing, MetroNet began to slide toward unprofitability in 1997 and was in fact unprofitable in 1999 and 2000. He further claims that several of MetroNet's competitors left the Centrex resale business and that one competitor went bankrupt because of per location pricing. Seeley's testimony as to MetroNet's unprofitability is disputed. MetroNet's bookkeeper testified that MetroNet was profitable in 1999. Although the bookkeeper did not address MetroNet's overall profitability in 2000, he testified that for the first nine months of that year, MetroNet's revenues from the resale of Centrex exceeded MetroNet's cost of purchasing Centrex from Qwest. As we noted in our discussion of the monopolization claim, this evidence of the injury to MetroNet is weak. So too is the evidence of injury to other resellers. However, our role on summary judgment is not to weigh the evidence. We must determine simply whether the evidence, when viewed in the light most favorable to MetroNet, creates a triable issue of fact. We hold that MetroNet has met this burden with respect to whether per location pricing alone had a sufficiently adverse financial impact to drive MetroNet and other resellers away. *Id.* at 546 ("When a firm's power to exclude rivals from a facility gives the firm the power to *eliminate* competition in a market downstream from the facility, and the firm excludes at least some competitors . . . a finding of monopolization, or at least attempted monopolization, is appropriate . . ." (emphasis in original)). Qwest came forward with some evidence of other reasons for MetroNet's unprofitability, but this evidence is insufficient to resolve the issue in Qwest's favor on summary judgment.

We hold that at this stage in the litigation MetroNet has adduced sufficient evidence to proceed with its essential facilities claim.

II. Settlement Agreement

A. Standard of Review

The parties dispute the standard of review we should apply to the district court's denial of MetroNet's motion to enforce its purported settlement agreement with Qwest. MetroNet urges de novo review,[29] whereas Qwest argues for an abuse of discretion standard.[30] The arguments of both parties assume that state law should govern the choice of the standard of review. We disagree. "[T]he proper standard of review is a question of federal procedure and is governed by federal law." *West v. State Farm Fire & Cas. Co.*, 868 F.2d 348, 350 (9th Cir.1989) (diversity breach of contract case). Although Washington's substantive law governs the interpretation of the settlement agreement, federal law governs the standard of review to be applied to the district court's decision. *Id.* We review a district court's decision whether to enforce a settlement

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[29] MetroNet cites *Lavigne v. Green*, 106 Wash.App. 12, 23 P.3d 515, 518 (2001); *Brinkerhoff v. Campbell*, 99 Wash.App. 692, 994 P.2d 911, 914 (2000); *In re Patterson*, 93 Wash.App. 579, 969 P.2d 1106, 1109 (1999); and *In re Marriage of Ferree*, 71 Wash.App. 35, 856 P.2d 706, 710-11 (1993). These cases hold that where the moving party relies on affidavits or declarations to show that a settlement agreement is not genuinely disputed, the standard of review should be the same as that applied in summary judgment proceedings.

[30] Qwest cites *Morris v. Maks*, 69 Wash.App. 865, 850 P.2d 1357, 1358 (1993), which in turn relied on our holding in *Callie v. Near*, 829 F.2d 888, 890 (9th Cir.1987).

agreement under an abuse of discretion standard. *See Callie v. Near,* 829 F.2d 888, 890 (9th Cir.1987).

MetroNet argues that an abuse of discretion standard should not apply because the material facts are not in dispute and the only issue is whether the parties manifested an intent to be bound by the settlement agreement. We have recognized a district court's inherent power to enforce a settlement agreement in a case pending before it. *See In re City Equities Anaheim, Ltd.,* 22 F.3d 954, 957 (9th Cir.1994). "To the extent the court's power to enforce a settlement agreement falls within the court's role as supervisor of litigation, then . . . this is precisely the type of determination that normally receives a deferential, abuse of discretion review." *Wilson v. Wilson,* 46 F.3d 660, 664 (7th Cir.1995) (citing *Pierce v. Underwood,* 487 U.S. 552, 558 n. 1, 108 S.Ct. 2541, 101 L.Ed.2d 490 (1988)).

B. Discussion

In Washington, settlement agreements are governed by general principles of contract law. *See Morris,* 850 P.2d at 1359. In determining whether an unexecuted settlement agreement constitutes a binding contract, Washington courts consider whether (1) the subject matter has been agreed upon, (2) the terms are all stated in the agreement and (3) the parties intended a binding agreement prior to the time of signing and delivery. *Id.* (citing *Loewi v. Long,* 76 Wash. 480, 136 P. 673, 674 (1913)). "If the subject-matter is not in dispute, the terms are agreed upon, and the intention of the parties plain, then a contract exists between them by virtue of the informal writings, even though they may contemplate that a more

formal contract shall be subsequently executed and delivered." *Loewi,* 136 P. at 674.

MetroNet has the burden of establishing the existence of an enforceable agreement. *Johnson v. Nasi,* 50 Wash.2d 87, 309 P.2d 380, 382 (1957) ("The burden of proving a contract, whether express or implied, is on the party asserting it, and he must prove each essential fact, including the existence of a mutual intention."). The district court concluded that MetroNet failed to establish the parties' intent to be bound prior to execution of the agreement. We agree.

"While the compromise of litigation is to be encouraged, negotiations toward a compromise are not binding upon the negotiators." *Eddleman v. McGhan,* 45 Wash.2d 430, 275 P.2d 729, 730 (1954). In determining whether the parties intended to be bound, we must look to the objective manifestations of their intent rather than to their subjective beliefs. As the Washington Supreme Court has stated:

> The Washington court has long adhered to the objective manifestation theory in construing the words and acts of alleged contractual parties. We impute to a person an intention corresponding to the reasonable meaning of his words and acts. Unexpressed intentions are nugatory when the problem is to ascertain the legal relations, if any, between two parties.

Plumbing Shop, Inc. v. Pitts, 67 Wash.2d 514, 408 P.2d 382, 384 (1965). We agree with the district court that "[t]he reasonable meaning of the parties' words and acts in this case was that the agreement needed to be signed for the settlement agreement to be complete and binding."

The agreement itself indicates that it was not to become legally operative until execution. First, the agreement requires Qwest to pay the settlement amount 10 days after the date of execution, implying that without execution, Qwest had no obligation to pay. ("Qwest shall pay to MetroNet the sum of $2,450,000 . . . within 10 business days of the execution date of this Agreement by MetroNet."). Second, the purported agreement required execution by both parties as attestation of their voluntary and informed consent. ("The parties agree, represent and warrant as follows. . . . They voluntarily execute this Agreement, after consulting with counsel and without being pressured or influenced by any statement or representation of any person acting on behalf of any other party, including any other party's officers, directors, employees, agents and attorneys."). Third, the final paragraph of the agreement provides for the method of signing and for the legal effect of signed counterparts. ("This Agreement may be signed in multiple counterparts which may be transmitted via facsimile, with the same effect as if all parties had signed the same agreement. All counterparts shall be construed as and shall constitute one and the same agreement. In proving this Agreement, it will not be necessary to produce or account for the original counterpart signed by the party against whom the proof is being presented.").

More importantly, Qwest manifested its unwillingness to be bound on October 6, 2000, when Qwest failed to sign the agreement as had been expected. As the district court pointed out, "[t]hat act should have put MetroNet on notice that all was not well with the agreement and that perhaps the parties had not reached a full and final resolution of their differences." Qwest's attorney informed

MetroNet's counsel on October 6 that she was having difficulty obtaining the signatures necessary to finalize the agreement. This, too, put MetroNet on notice that no final deal had been struck. Furthermore, MetroNet's repeated efforts to obtain Qwest's signature even after October 6, 2000, contradict MetroNet's position that the settlement agreement was intended to be legally operative prior to signing.

CONCLUSION

For the reasons stated, we affirm the district court's denial of MetroNet's motion to enforce its purported settlement agreement with Qwest, reverse the district court's grant of summary judgment on MetroNet's monopolization[31] and essential facilities claims and remand for further proceedings. Each party shall bear its own costs.

AFFIRMED in part, REVERSED in part and REMANDED.

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[31] Except as to the district court's grant of summary judgment adverse to MetroNet on its claim of attempted monopolization, as discussed in notes 1 and 6, *supra*.

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

METRONET SERVICES CORPORATION and METRONET TELEMANAGEMENT CORPORATION, Plaintiff, v. QWEST CORPORATION, Defendant.	CASE NO. C00-0013C **ORDER** (Filed Apr. 16, 2001)

This matter comes before the Court on defendant's motion for summary judgment (Dkt. No. 47). The Court, having considered the briefs submitted by the parties and determined that oral argument is not necessary, hereby finds and rules as follows.[1]

I. Background

This is an antitrust case between Qwest, a large telecommunications company that, among other business interests, owns the telecommunications infrastructure in many western states, including Washington, and Metronet, a reseller of business phone service.

This dispute concerns the manner in which Qwest prices a telecommunications product called Centrex.

[1] Plaintiff's motion for leave to file a memo in support of its motion to file an overlength brief (Dkt. No. 65) is GRANTED. Plaintiff's motion for leave to file an overlength brief (Dkt. No. 57) is GRANTED.

Centrex is a business phone service that consists of two components: multiple telephone line access to Qwest's physical telephone network (the access component), and calling features, such as caller ID, intercom calling, and long distance service (the features component). Qwest offers a volume discount on the access component of Centrex. The Centrex customer need not purchase each telephone line individually at Qwest's flat rate for business service (the 1FB rate); rather, the Centrex customer gets all the lines it needs at a substantial discount from the 1FB rate. The price of Centrex is competitive with the price of purchasing a PBX and a 1FB line. Smaller businesses, those with 20 lines or fewer, do not qualify for the volume discount reflected in the Centrex rate, and generally cannot justify the expense of a PBX system. Qwest expects small businesses simply to purchase the number of 1FB lines they require, and purchase the calling features they require on the open market.

Metronet's business consists mainly of purchasing Centrex services from Qwest and reselling those services to aggregations of smaller businesses. Because of this discount, there was a substantial difference between the cost at which Metronet could provide Centrex service to an aggregation of small businesses and the price at which a small business could purchase multiple 1FB lines. By pricing Centrex above the cost Metronet incurred in providing the service to the small businesses but below the price at which the small businesses could purchase multiple 1FB lines, Metronet was able to reap handsome profits.

Qwest charges separate fees for the access component and the features component of Centrex, but it requires consumers who purchase one component also to purchase

the other component. Initially, the price Qwest charged Metronet for the features component had been calculated based on the number of Centrex packages Metronet purchased from Qwest without regard for the number of individual phone lines to separate locations covered by the Centrex package. In 1997, Qwest instituted a change in their pricing policy regarding the features component of Centrex; the new price is calculated based on both the number of Centrex packages and the number of individual phone lines to separate locations. Qwest refers to this pricing policy as "per location pricing" of Centrex. Because of the change in pricing policy, Metronet must pay significantly more for the Centrex services that it then resells to the aggregated smaller businesses. According to Metronet, Qwest's institution of per location pricing prevents Metronet from pursuing its reselling business profitably.

At roughly the same time that Qwest instituted its per location pricing policy, the local telephone market was opened to competition pursuant to the Telecommunications Act of 1996 ("The Telecom Act"), 47 U.S.C. § 202 et seq. As a result, Qwest significantly reduced the price of its 1FB line, and hence also reduced the price of the access component of Centrex. Metronet now purchases the two components of Centrex at a total price much lower than the price it paid before the Telecom Act went into effect. Because of the per location pricing policy, however, Metronet pays more (and proportionately more) for the features component due to the multiple locations of its aggregated businesses. In fact, Metronet now pays a price for the features component that is much closer to the going rate in the competitive market for calling features. Therefore, the price at which Metronet provides calling features to its customers is now much closer to the price at which

those customers could purchase calling features on the open market. And, because of the reduction in the price of 1FB lines, the price Metronet charges its customers for the access component is now much closer to the price at which those customers could purchase 1FB lines from Qwest. Thus, the total price that Metronet charges its customers for Centrex services is now much closer to the price those customers would pay by purchasing 1FB lines and calling features independently. The effect of the reduction in price for 1FB lines and the per location pricing policy has been to reduce, if not eliminate, Metronet's profit margin.

Metronet contends that Qwest's per location pricing of its Centrex product violates federal antitrust laws. Metronet brings three causes of action. First, Metronet claims that Qwest has denied Metronet access to an essential facility in violation of § 2 of the Sherman Act. 15 U.S.C. § 2. Second, Metronet claims that Qwest has illegally maintained a monopoly of local business phone service, also in violation of § 2 of the Sherman Act. Third, Metronet claims that Qwest has illegally attempted to monopolize local business phone service in violation of § 2 of the Sherman Act.

II. Summary Judgment Standard

Summary judgment is appropriate where there are no issues of material fact and where the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). The Supreme Court has rejected the contention that antitrust plaintiffs "can get to a jury on the basis of the allegations in their complaints, coupled with the hope that something can be developed at trial" to support the allegations. *Celotex Corp. v. Catrett,* 477 U.S. 317, 322 (1986).

"Summary judgment is particularly important in antitrust cases because of the fearful dimensions such cases can assume and because of the powerful incentives to offer claims or defenses of little merit." Areeda and Hovenkamp, Antitrust Law, § 322 (1995). The Supreme Court has made clear that the limitations on the use of summary judgment in antitrust cases, if any, attach to claims where motive and intent play a crucial role. *Poller v. Columbia Broadcasting System, Inc.*, 368 U.S. 464, 473 (1962). The theory is that these issues turn on evidence that is peculiarly within the possession of the defendant, and so should not be dismissed summarily. See Areeda and Hovenkamp, Antitrust Law, § 322c (1995). Where, as in this case, the issues do not turn on such evidence, there is no proscription on the use of summary judgment.

III. Essential Facilities Claim

It is well-settled law in the Ninth Circuit that to establish an essential facilities claim the plaintiff must prove four elements:

> (1) Defendant is a monopolist in control of an essential facility;
>
> (2) Competitors of the monopolist are unable to duplicate the facility;
>
> (3) The monopolist has refused to provide the competitors access to the facility; and
>
> (4) It is feasible for the monopolist to provide access to the facility.

Ferguson v. Greater Pocatello Chamber of Commerce, Inc., 848 F.2d 976, 983 (9th Cir. 1988); *Alaska Airlines, Inc. v. United Airlines, Inc.*, 948 F.2d 536, 542 n.9 (9th Cir. 1991).

Qwest claims, and the Court agrees, that Metronet cannot prove elements (1) and (3).

The parties are somewhat unclear about what they consider to be the essential facility in this case. The Court finds that it is unlikely that a precise definition is required to decide the issues before this Court.

Under element (1), Qwest controls an essential facility only if it is able to eliminate competition in the downstream market. *Alaska Airlines,* 948 F.2d at 544. The parties agree that the downstream market is, "The retail provision of wireline switched local exchange and exchange access services to small business customers in the Seattle/Tacoma area." Metronet's Memorandum in Opposition to U.S. West's Motion for Summary Judgment, p. 3, n.3; Qwest's Memorandum in Support of its Motion for Summary Judgment, p. 14, n.18. In short, the relevant market is the retail phone service for small businesses in the Seattle/Tacoma area.[2]

[2] Metronet is exclusively a reseller of Centrex services, so it actually competes in only a subsection of the market for local business phone service. Nevertheless, it would be inappropriate to define the relevant market more narrowly for the purposes of Metronet's essential facilities claim because an essential facilities claim requires the plaintiff to prove that there is a relevant market in which the plaintiff and defendant compete. See, e .g., *Intergraph Corp. v. Intel Corp.,* 195 F.3d 1346, 1357 (Fed. Cir. 1999) ("[T]here must be a market in which plaintiff and defendant compete, such that a monopolist extends its monopoly to the downstream market by refusing access to the facility it controls"). Qwest does not compete in the reselling niche of the larger local business telephone service market. Therefore, limiting the relevant market to reselling would be inappropriate in the context of an essential facilities claim.

Qwest is not capable of eliminating competition in the market for local business telephone service. The Telecom Act itself requires Qwest to open up access to at least part of its essential facility, its physical network, to firms with their own switching facilities wishing to interconnect with that network. 47 U.S.C. § 251(d)(2). These firms are then able to provide their own features and compete with Qwest in the market for local business phone service. The Telecom Act also requires Qwest to provide access to its calling features. 47 U.S.C. § 153(29). Metronet asserts, however, that Qwest could make access to its calling features financially unrewarding by adopting exclusionary pricing policies such as per location pricing. In a market as broadly defined as local business phone service, however, this point carries little force. Even if the per location pricing policy makes the calling features available to Metronet and other firms on terms that make resale of those features unprofitable, there will still be competition in the market for local business phone service from wholesalers and from firms with their own facilities who have interconnected with Qwest's physical network under the Telecom Act. Therefore, Qwest does not control its essential facilities because it cannot eliminate competition in the relevant market.

Under element (3), Qwest would deny Metronet access to its essential facility if it simply refuses Metronet any access to its facility, or prices access to that facility in a way that would "drive [Metronet] away." *Alaska Airlines,* 948 F.2d at 545. It is clear that Qwest has not denied Metronet all access to its essential facility because Metronet continues to this day in its business of reselling Centrex. The issue, therefore, is whether Qwest's per

location pricing policy has denied Metronet access to Centrex by "driving [Metronet] away."

Qwest will be driving Metronet away if its pricing policy makes it unprofitable for Metronet to continue reselling Centrex and there is no other plausible alternative way in which Metronet can access Centrex and resell the service at a profit. It is unclear from the record whether Metronet remains profitable. Metronet's CEO asserted under oath that the firm is no longer profitable. Declaration of Kenneth Seeley § 4. Metronet's accounting controller, however, stated under oath that the firm remained profitable through 2000. Deposition of Shane Kordosis, 106:2-6, 115:2-4, 117:2-16, 120:8-121:5.

If Metronet does indeed remain profitable, then it cannot rightly claim to have been denied access to Centrex. Resolving this confusion in favor of Metronet by supposing that it is no longer profitable, however, does not help Metronet because Metronet has not shown that any unprofitability was caused solely by Qwest's pricing policy. Qwest has supplied substantial evidence that Metronet's unprofitability, if any, can be explained by numerous factors other than Qwest's pricing policy.[3] Qwest points to

[3] Qwest also argues that Metronet is not entitled to access to Centrex on terms that guarantee Metronet's profitability, and should not be permitted to proceed to trial simply by alleging that the terms on which they are granted access to Centrex make it unprofitable for them to pursue their reselling business. *Laurel Sand & Gravel, Inc. v. CSX Transport., Inc.*, 924 F.2d 539, 545 (4th Cir. 1991) (granting summary judgment on an essential facilities claim even though the rate charged for access made it unprofitable for the plaintiff; "the reasonable standard of access factor can not [sic] be read to mean the assurance of a profit for [the plaintiff]"). This argument is unavailing for two reasons: First, no firm can be guaranteed a profit by the terms on which they are granted access to an essential facility because there are

(Continued on following page)

(1) the large reduction in the rate of 1FB lines, (2) the increase in competition in the market for local business phone service, (3) the fact that Metronet several times lost management and sales personnel who were not replaced immediately, and (4) the fact that Metronet failed actively to seek new sales of Centrex. See Qwest's Memo in Support at 4-5, and supporting documents. Separately and in concert, these claims provide alternative explanations for Metronet's assumed financial difficulties. By producing evidence in support of these claims, Qwest has produced evidence that calls into question Metronet's assertion that Qwest's per location pricing policy has caused its unprofitability. Faced with this evidence, Metronet's burden on summary judgment requires it to respond with evidence that would permit a rational trier of fact to find that the per location pricing policy, without these other factors, would be sufficient to cause Metronet to be unprofitable. See *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87 (1986). And given that Qwest has produced this evidence, mere dispute or disbelief on the part

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myriad potential causes of unprofitability for which the terms of access could not compensate. The force of the Fourth Circuit's statement for this case, then, is not that Qwest may price with impunity no matter what effect its pricing policy has on its competitors in the downstream market. Rather, the statement merely means, in this context, that Qwest cannot be expected to compensate with its pricing policy for other factors that may cause Metronet to be unprofitable. Second, Qwest is well-aware that the Ninth Circuit would find a denial of access where the defendant's terms of access to an essential facility would "drive [defendant's] competitors away." See Qwest's Memo in Support at 12. If the per location pricing policy by itself caused Metronet to be unprofitable, and Metronet can prove this, then Qwest might be driving Metronet away, and therefore denying access under Ninth Circuit interpretation of the denial of access prong of the essential facilities doctrine.

of Metronet is not enough to carry its burden on summary judgment.

Metronet responds inadequately to the evidence produced by Qwest showing other potential causes of Metronet's assumed unprofitability. Metronet states that whether it is profitable and whether organizational changes within Metronet might have caused any unprofitability are irrelevant to the issues before the Court. Under Ninth Circuit law, the Court finds both issues highly relevant. The issue of Metronet's profitability is relevant because if it is profitable for Metronet to continue as a reseller of Centrex, Metronet has not been denied access to an essential facility. The issue of whether Metronet's organizational changes have caused Metronet to be unprofitable is relevant because unless Metronet can produce at least some evidence that Qwest's per location pricing policy has caused its unprofitability without any of the other potential causal factors cited by Qwest, Metronet has not shown that it has been denied access to an essential facility. Thus, Metronet's unilateral declaration that the issues of its unprofitability and potential causes of its unprofitability are irrelevant is inadequate. Moreover, Metronet does not dispute Qwest's evidence that competition in the relevant market has increased. Therefore, Metronet has not met its burden of showing the existence of a genuine issue of material fact whether Qwest's per location pricing policy has denied Metronet access to an essential facility.

Metronet is also unable to show that there are no reasonable alternative means of access to Qwest's essential facility. Qwest currently sells 1FB lines and certain calling features wholesale, which allows other firms to purchase these services and resell them at the retail level

for profit. Metronet, in fact, has entered into an agreement with Qwest to purchase such services wholesale. Metronet claims that Qwest has refused to make certain calling features available at the wholesale level (e.g., voicemail and long-distance), but Metronet does not rebut Qwest's evidence that those features can be purchased elsewhere at competitive prices on the open market. Therefore, as far as Metronet has shown, there are reasonable alternative means of access to Qwest's essential facility.

Metronet has not shown that its unprofitability, if any, is caused by Qwest's pricing policy. Nor has Metronet shown that alternative means of access to Qwest's essential facility are unavailable. Therefore, Metronet has not come forward with evidence sufficient to show that it can establish that Qwest has denied Metronet access to an essential facility. Qwest's motion for summary judgment on this claim is therefore GRANTED.

IV. Illegal Monopolization

To prove an illegal monopolization claim under the Sherman Act § 2, the plaintiff must establish three elements:

(1) The defendant possesses monopoly power in the relevant market;

(2) The defendant willfully acquired or maintained its monopoly power through exclusionary conduct; and

(3) The defendant caused antitrust injury.

American Prof'l Testing Serv., Inc. v. Harcourt Brace Jovanovich Legal & Prof'l Publ'ns., Inc., 108 F.3d 1147, 1151 (9th Cir. 1997). If Qwest is able to show that Metronet cannot establish any one of these elements, summary

judgment on the monopolization count must be granted. In fact, Qwest has shown that Metronet can establish none of these elements.

The Ninth Circuit has been very clear about the test to establish element (1): "[M]onopoly power is the power to exclude competition or control prices." *United States v. Syufy Enters.*, 903 F.2d 659, 664 (9th Cir. 1990). This test is disjunctive, and is not satisfied in this case.

While it is clear that Qwest has a monopoly share of the relevant market (it has more than a 95% share of the local retail business phone service market), it is highly unlikely that Qwest's high market share confers upon it monopoly power (the power to exclude competition or control prices). Qwest has presented undisputed evidence that, since the Telecom Act became effective, there are, or have recently been, as many as 17 competitors in the local retail business phone service market. See Bogus Deposition, 78:2-23, Tatman Deposition, 60:2-17, Beckett Deposition, 35:8-36:1, 91:17-92:5. While Metronet correctly points out that no other competitor in this market has more than a 1.1% share of the market, that is easily explained by the fact that the market has been open to competition for less than 5 years. Given that Qwest had a 100% share of the market at that point, it would be surprising if their market share diminished more quickly than it has because some barriers to entry remain in local telecommunications markets. Metronet's expert overstates the case for high entry barriers in this market, see Metronet's Memo in Support at 21-22 and supporting documents, yet some barriers do remain. For example, Qwest has strong brand name identification, which tends to breed consumer loyalty. Also, certain types of new entrants (those wishing to maintain their own switching facilities and merely

interconnect physically with Qwest's network) must absorb substantial start-up costs that Qwest has already incurred. These barriers will diminish in time as new firms build their infrastructure, gain a toehold in the market, advertise more widely, and gain wider recognition. Thus, the current distribution of market share is unlikely to be stable; a 95% market share now could well evaporate in the coming years without antitrust involvement. Therefore, it is unlikely that Qwest can exclude competition.

Qwest is also unable to control prices in the local business phone service market. First, phone service is not the type of commodity that is susceptible to price increase through output reduction.[4] Second, the fact of competition in the wake of the Telecom Act prevents Qwest from unilaterally raising prices. Third, while Qwest can control the price it charges for access to phone service to some degree, the Washington Utilities and Transportation Commission (WUTC) mitigates the extent to which Qwest can simply dictate prices for access to phone service. Metronet points out that Qwest can determine its price for calling features because the WUTC does not control that aspect of Qwest's service. Qwest notes correctly, however, that calling features are not regulated by the WUTC because that market is open to competition. Thus, the

[4] According to standard price theory, prices increase as output decreases and demand rises. See Hovenkamp, Antitrust Law and Policy, § 1.1. Thus, monopolists in markets to which price theory applies can increase prices in the market by reducing output and driving up demand. Oil companies, for example, can increase demand, and hence price, by making less oil available. Phone service, however, is not a commodity susceptible to output limitation in the way that oil is. Thus, Qwest cannot control the prices for the service it provides in way that oil companies can control the prices for the product they provide.

WUTC limits Qwest's ability to control access prices, and the competitive market for calling features limits Qwest's ability to control prices for calling features. For the foregoing reasons, then, Qwest is unable to control prices in the local business phone service market.

To prove exclusionary conduct under element (2), Metronet must show not merely that Qwest's per location pricing policy has harmed competitors (e.g., Metronet), but that the policy constitutes a harm to competition. *Oahu Gas Serv., Inc. v. Pacific Res., Inc.*, 838 F.2d 360, 370 (9th Cir. 1988). The test for harm to competition is whether consumer welfare has been harmed. *Rebel Oil Co., Inc. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1433 (9th Cir. 1995). Consumer welfare, in turn, has been harmed if there has been a decrease in allocative efficiency and an increase in the price of goods beyond competitive levels. *Id.* "Allocative efficiency" requires that society's resources be allocated efficiently. Hovenkamp, Antitrust Law and Policy, § 2.3 (1994).

The test for element (2) is conjunctive: whether consumer welfare is harmed depends on both a decrease of allocative efficiency and an increase in price. Qwest produced unrebutted evidence that the overall cost of Centrex to consumers dropped significantly when the local phone markets were opened up to competition under the Telecom Act. The fact that competition in the local business phone service market can keep the price of Centrex overall below the pre-price-change level is sufficient to constitute no harm to consumer welfare. And without harm to consumer welfare, Qwest cannot be found to have engaged in exclusionary conduct. And without exclusionary conduct, element (2) in a monopolization claim is not satisfied.

To establish an antitrust injury under element (3), the plaintiff must show that it has suffered an "injury of the type the antitrust laws were intended to prevent" and that the injury "flows from that which makes the defendants' acts unlawful." *Atlantic Richfield Co. v. USA Petrol. Co.*, 495 U.S. 328, 334 (1990). The question of antitrust injury is separate from the question of injury-in-fact and causation of that injury by Qwest's conduct. See Hovenkamp, Antitrust Law and Policy, § 16.3c. Metronet may have suffered an injury, and that injury may indeed have been caused by Qwest, but it is not an antitrust injury unless the injury is caused by conduct by Qwest that is illegal under the antitrust laws. *Brunswick Corp. v. Pueblo Bowl-O-Matic, Inc.*, 429 U.S. 477, 489, 97 S.Ct. 690, 697 (1977).

Because Metronet has not shown that Qwest's actions satisfy the test for monopolization, they cannot show that any injury Metronet has suffered is an antitrust injury and summary judgment on the monopolization claim is therefore GRANTED.

V. Attempted Monopolization

To prove an attempted monopolization claim under the Sherman Act § 2, the plaintiff must establish three elements:

(1) The defendant has a specific intent to monopolize a relevant market;

(2) The defendant has engaged in predatory or anticompetitive conduct; and

(3) The defendant has a dangerous probability of success.

Alaska Airlines, Inc. v. United Airlines, Inc., 948 F.2d 536, 542 (9th Cir. 1991).

Qwest suggests that the evidence brought to support its motion for summary judgment on the monopolization charge is sufficient to support its motion for summary judgment on the attempt charge as well. Indeed, some courts and scholars have wondered whether there is an attempt offense that is not simply identical to the monopolization offense. See P. Areeda and D. Turner, Antitrust Law, § 820 (1994). To the extent that there is, it consists in elements (1) and (3) listed above.

Qwest, for its part, simply declares that Metronet can prove none of the three elements. But Qwest produces no evidence at all regarding elements (1) and (3). Qwest does suggest, albeit somewhat obliquely, that the evidence and arguments brought forth in response to the monopolization charge are sufficient to establish that Metronet cannot prove element (2). Because the test is conjunctive, Qwest need only show that Metronet cannot prove element (2).

Qwest is correct that the attempt offense has as an essential element an anticompetitive conduct requirement that is essentially no different from the monopolization offense's exclusionary conduct requirement. Thus, that Qwest has produced evidence tending to show that Metronet cannot prove exclusionary conduct means that it has produced evidence tending to show that Metronet cannot prove anticompetitive conduct. Metronet has not produced evidence sufficient to allow a rational fact finder to find that Qwest has engaged in anticompetitive conduct. Thus, Metronet has not come forward with evidence sufficient to establish element (2). Qwest's motion for summary judgment on the attempted monopolization claim is therefore GRANTED.

VI. Summary

Where, as here, the issues in an antitrust case do not turn on evidence of motive and intent that is peculiarly within the hands of the defendant, there is no proscription on the use of summary judgment peculiar to antitrust cases. Because Metronet cannot prove each element of the causes of action alleged, Qwest's motion for summary judgment is hereby GRANTED in its entirety. The clerk is directed to enter judgment in favor of Qwest.

SO ORDERED this 16th day of April, 2000.

/s/ John C. Coughenour
CHIEF UNITED STATES
DISTRICT JUDGE

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

METRONET SERVICES CORPORATION; METRONET TELEMANAGEMENT CORPORATION, Plaintiffs-Appellants, v. US WEST COMMUNICATIONS, Defendant-Appellee.	No. 01-35406 D.C. No. CV-00-00013-JCC **ORDER** (Filed Dec. 17, 2004)

BEFORE: BROWNING, FISHER and TALLMAN, Circuit Judges.

The panel has voted to deny appellants' revised joint petition for panel rehearing. Judges Fisher and Tallman voted to deny the petition for rehearing en banc, and Judge Browning recommended denial of the petition for rehearing en banc.

The full court has been advised of the revised joint petition for rehearing en banc and no judge of the court has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

Appellants' revised joint petition for panel rehearing and petition for rehearing en banc, filed November 22, 2004, is DENIED.

Chief Judge John C. Coughenour

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

METRONET SERVICES CORPORATION, and METRONET TELEMANAGEMENT CORPORATION, Plaintiffs, v. US WEST CORPORATION, a Colorado corporation, Defendant.	Civil No. C00-0013 C DECLARATION OF KENNETH C. SEELEY IN SUPPORT OF MEMORANDUM IN OPPOSITION TO DEFENDANTS MOTION FOR SUMMARY JUDGMENT

Filed Under Seal

Chief Judge John C. Coughenour

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

METRONET SERVICES CORPORATION, and METRONET TELEMANAGEMENT CORPORATION, Plaintiffs, v. US WEST CORPORATION, a Colorado corporation, Defendant.	Civil No. C00-0013 C DECLARATION OF KENNETH C. SEELEY IN SUPPORT OF MEMORANDUM IN OPPOSITION TO DEFENDANTS MOTION FOR SUMMARY JUDGMENT (Filed Mar. 5, 2001)

Kenneth C. Seeley declares and states as follows:

1. I make the following true and correct statements based upon my personal knowledge.

2. I am President of MetroNet Services Corporation and MetroNet Telemanagement Corporation (collectively "MetroNet") in this action.

3. I have extensive experience in both the technical and management sides of the telecommunications industry. I was employed in the field from 1955 to 1968 as a lineman, splicer, and central office technician for Pacific Telephone in California. In 1972, I worked at Pacific Northwest Bell in Tacoma as a frameman, connecting the central office equipment to the outside switching equipment. After briefly leaving the industry, I returned to Pacific Northwest Bell in 1973 in the Seattle marketing department. I worked as a communications consultant and sold equipment and services including standard telephones, key systems, and Centrex services to business customers. I also worked in market management. In 1978, I transferred back to Pacific Telephone in California and worked in their marketing department for approximately two years. My responsibilities included sales and implementation of telephone systems, including key systems and small Private Branch Exchange ("PBX") for small businesses. After again leaving Pacific Telephone and the telecommunications industry, I returned to the industry in 1985, forming a partnership that has since been incorporated as MetroNet. I have been president of MetroNet for the last 15 years and have been the sole owner since July 1986.

4. US West claims that MetroNet is a profitable business. Yet it is precisely because of US West's pricing

schemes that are challenged in this action that this is no longer true. As the sole owner of MetroNet, I am the one most knowledgeable about the true profitability of MetroNet.

First, MetroNet's "profitability" on a year-by-year basis is significantly distorted by the fact that we periodically receive refunds from US West for incorrect or overbilled charges incurred months or years earlier that distort the true picture of the revenue stream received as a result of the reselling of Centrex Plus services. I know for a fact that this has made some years, appear more profitable than they truly were, since refunds received in that year were actually the result of over billings from prior years. This means that in some years our income was understated, and in other years it was overstated as a result of US West's credits.

Second, US West's imposition of its per-location-pricing scheme had a devastating impact. It is true that US West's re-imposition of the per-location-pricing on the features aspect of Centrex Plus in May 1997, did not immediately drive MetroNet into bankruptcy. Nonetheless, it has had a devastating impact on the business and has led MetroNet slowly and surely towards insolvency. I have reviewed the books and records of my business and they show that MetroNet's profitability has decreased steadily over time with 1999 representing a year in which we barely broke even. The trend in profitability has been directly and decidedly downwards since 1997. In fact sometime in mid-1999 we began to operate in the red. The revenue from the monthly operations turned negative at this time. In the year 2000 we were definitely in the red the entire year and in fact had to borrow over one-half million dollars in order to stay afloat It is my opinion that

US West's per-location-pricing scheme is a direct cause of our slide towards insolvency. I testified in my deposition that MetroNet was not profitable in 1999 and 2000 and I stand by that statement.

5. US West alleges that MetroNet has suffered from too many organizational changes. This allegation is ironic because it is US West's per location pricing scheme that has so negatively impacted our financial picture and, not surprisingly, affected our ability to hire and retain employees.

6. MetroNet is not the only telecommunications company that has suffered financially as a result of US West's pricing scheme. I am familiar with our competitors in the reselling of Centrex Plus. A number of them no longer compete in reselling Centrex. These include Global Crossing-Frontier ETI, Shared Communications, and USLD. I am also aware that GST, another reseller of Centrex Plus, went bankrupt last year. GST sold its assets to Time Warner Communications. However, I am also aware that Time Warner was not interested in purchasing the Centrex resale part of GST's business and as a result Centrex business lines were virtually given away.

7. US West also argues that MetroNet has "other methods" of accessing US West's network. This is also false. For a number of years we considered signing a wholesale interconnection agreement with US West. However, US West refused to include the existing long-distance and voicemail services in the wholesale interconnection agreement. US West wanted to take away these basic services. Any end-user would have had to move to another service provider in order to get these very basic services or would have had to provide for themselves. This

meant that the wholesale interconnection agreement option was not a realistic option at all. I would estimate this would cost MetroNet 30%-40% of its business. US West has more recently indicated that it would be willing to sign a wholesale interconnection agreement with us but we would first have to give up our Centrex Plus retail rate stability agreements. Rate stability agreements are the part of the contract that allow us to retain the cheaper and more level rates. The net result of US West's refusal to allow us to retain rate stability is that if we opted for the wholesale interconnection agreement we would end up paying more than we now pay in the retail context. In addition, discounted wholesale rates on Centrex Plus were not set until late 2000. Even today they are not firmly established. US West also alleges that we could resell 1FBs. US West knows that this is an illusion. If we switched and resold 1FBs we would be insolvent immediately. Finally, US West argues we could build our own facilities to access US West's network. This is likewise an illusion. New switches and other technology needed to access the US West network would cost millions of dollars and it is well beyond the ordinary means of a reseller such as MetroNet and this is a barrier to entry.

8. Over the years Metronet has repeatedly asked US West to unbundle the various elements to Centrex Plus and to allow us to buy each element on an unbundled basis. US West has refused. In order for us to purchase the Centrex service we resell, US West has required us to buy the deregulated features component along with the monopoly element line and the network access register.

9. US West increased prices for Centrex Plus several times since May of 1996. For example, US West increased NAC rates by $2 per line on a portion of the NACs on May

6, 1996, and increased the features component ("the SFJXR") rate by $2 on February 20, 1997. It restored per location pricing on May 8, 1997, and the change from a system pricing methodology to per location pricing methodology effectively implemented a huge rate increase on Centrex Plus resellers. I estimate this increase to be around 400% depending on the size of the system. Also on May 8, 1997, US West raised the rate by $2 on the rest of the NACs It increased the non-recurring charge for line changes for converting from one type of business telephone service to Centrex type service from $20 to $48 in mid-1999. It also imposed a $10 charge for changes to long distance carriers ("PIC"), which was previously included within this service that US West provided as part of the $20 customer change charge. On May 15, 1999 it implemented a "chip-in" charge for translating listed directory numbers from outside the Centres Plus customer group. This was a new charge that imposed additional costs on Centrex customers.

I certify under the penalty of perjury under the laws of the State of Washington that the preceding is true and correct to the best of my knowledge.

Dated the 5th day of March, 2001 in Seattle, Washington.

/s/ Kenneth C. Seeley
Kenneth C. Seeley

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

METRONET SERVICES CORPORATION, and METRONET TELEMANAGEMENT CORPORATION,	)	
Plaintiffs,	)	Civil No.
V.	)	C00-0013C
U S WEST COMMUNICATION, INC., a Colorado corporation, Corporation,	)	
Defendant.	)	

DEPOSITION OF
DENNIS HRUSKA
DENVER, COLORADO
DECEMBER 11, 2000
1 p.m.

* * *

[38] A Not that I recall.

Q Do you have any recollection of any of the meetings you had with Mr. Hilderbrand wherein the issue of arbitrage was discussed?

A The answer to your question is no.

Q Did you have an understanding that U S West management considered arbitrage to be a problem that needed to be resolved?

A I believe the answer is yes.

Q How did you acquire that understanding?

A From Jim Hilderbrand.

Q In these meetings you just testified to?

A I believe so.

Q Had this understanding that you developed been acquired prior to your implementing the per location pricing?

A Say that again.

Q I am looking for a time in terms of your acquiring understanding of arbitrage. Would this understanding have been developed by you prior to the implementation of per location pricing?

A Yes.

* * *

[75] arbitrage other than the revenue?

A Not that I am aware of.

Q Was the revenue concern the underlying reason why U S West was concerned about arbitrage?

A I believe that is the case. Generically in a product role minimizing arbitrage is always something a product organization tries to do.

Q Upon what do you base that?

A Experience as a product manager.

Q And that would be experience as product manager in the Centrex product arena; is that correct?

A Well, not just Centrex, but PBX and key systems and so forth.

Q Have you been a product manager in the PBX area?

A Yes.

Q When was that?

A In 1993 to the 1997, 1998 time frame.

Q This would be after you left Centrex?

A Correct.

Q And in the product management area

* * *

[CONFIDENTIAL RESTRICTED]

MEMORANDUM

December 17,1996

To: Judi Hand

Fr: Kirk Nelson /s/ Kirk

cc: Jim Smith

Re: Centrex Resale Competition in Washington

The purposes of this memo are to provide you with an update on the competitive situation we face in Washington from resold Centrex service and to further discussions around specific actions we can take to address it as soon as possible.

The Competitive Situation and Financial Implications:

The current Washington tariff structure for Centrex Plus, 1FB/FL and features offers a profitable, relatively low-risk opportunity for Centrex resellers to win significant market share of 1FB customers (mainly small business) in Washington. In essence, it appears that resellers can operate with positive margins while reselling Centrex Plus at anywhere from 10 to 35 percent discounts to the 1FB/FL, not including features. For such a discount, the customer receives a service that is not easily distinguished from the 1FB/FL and which in fact includes more features. As a result a number of resellers such as NextLink, MetroNet and Frontier are aggressively building customer bases in Spokane and the Seattle/Tacoma area. Indeed, we estimate that there are over 33,000 resold Centrex lines in these markets. The situation is especially critical in Spokane, where NextLink and Frontier have captured an

estimated 23 percent of the market.[1] In NextLink's case, the company has approximately 50 people in Spokane including a large, aggressive direct sales force.

From a financial perspective, USWC continues to derive revenues from Centrex resellers. However, even with Centrex line stimulation from lower rates, the overall revenue impact to USWC is negative. For example, the monthly recurring revenue for a Washington 1FB is about $38 while the average for a Centrex line is estimated to be around $15[2]. Thus, even with a line stimulation factor of 1.5[3], USWC's loss of recurring revenue would be $15.50 (40%) for each 1FB/FL lost. Assuming the current 30,000 Centrex lines were gained at the expense of 20,000 1FBs. USWC's monthly revenue loss would be over $300,000 per month. Lost features associated with the 1FB would add to these losses. Also, resellers such as Frontier offer toll services – the aggregation of which would also negatively impact USWC revenues.

The overall margin impact is unclear. But, if there are expenses USWC incurs for the 1FB/FL that it does not for resold Centrex (e.g., customer service), these expenses appear insubstantial. Thus, it seems likely that the margin impact is also significantly negative.

The financial impact of Centrex resale will be more severe if the Washington Rate Case Order is enacted. The RCO

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[1] Together, NextLink and Frontier appear to have 11,332 Centrex Station lines as of November, 1996. This is compared to 38,924 1FB, 1FL, and MB lines to estimate market share.

[2] Rough estimate based on Centrex tariff and aggregated billing data.

[3] Rule of thumb used by product managers.

would change how Centrex lines are aggregated for volume discounts. The current practice is to aggregate by location. The RCO would aggregate lines by exchange. Product management believes the impact of the RCO on the Centrex business will be a negative $6 million in Washington. From the resellers perspective, this aggregation approach will only improve margins and their ability to compete. Also, our resale arbitration agreements indicate that competitors such as AT&T, MFS and MCI will receive further discount off of the current volume discounts, creating a highly lucrative resale proposition that is perhaps superior to reselling 1FB/FL service.

Financial considerations aside, the most troubling aspect of customer losses to Centrex resellers is that U S WEST loses its direct relationship with these customers, and therefore the opportunity to market additional services and new products that would generate incremental revenues. Also threatening is that Nextlink is rapidly building a fiber network in Spokane, to which it could eventually shift Centrex customers – thereby eliminating USWC entirely.

Current/Future Initiatives Addressing Centrex

To date, USWC's primary strategy regarding Centrex has been its attempt to "grandparent" the service and then introduce a Centrex Prime in its place. In Washington, we anticipate a grandparenting decision in January 1997. However, we are not optimistic for a favorable ruling given that Centrex has yet to be grandparented in other jurisdictions. And, even if the WUTC rules in favor of USWC, the grandparenting provisions would allow resellers to grow at a rate of 100% every two years by location. Given the large

resale market share in Spokane, this level of growth would be alarming.

USWC also implemented a "Welcome Back" tariff which waived non-recurring charges and offered credits of up to $100 per location for toll service when customers returned to U S WEST from a competitor. This promotional tariff only generated a small number of winbacks in Washington and expired on December 14.

Finally, it is our understanding that given financial concerns, product management may not introduce Centrex Prime in Washington under the line aggregation methodology prescribed by the RCO. We have been told that the Centrex 21 product is scheduled for launch sometime in 1997. However, given its price point this product will not effectively address the competitive threat posed by Centrex resellers.

In sum, there is no existing or forthcoming product that effectively addresses Centrex resale competition.

Factors Impairing Our Ability to Win Back Customers

Under current conditions, there are two barriers which complicate any attempt by USWC to winback [sic] customers: number portability and non-recurring charges. With number portability, USWC's current practice is to allow customers switching to Centrex resellers to take their numbers with them. The numbers are "burned" into the resellers' common blocks. Unfortunately, there is no obligation on the part of the reseller for reciprocal treatment (i.e., to give these numbers back to USWC). This creates a barrier to switch back to USWC. Also, customers switching from resellers back to USWC must do so

through the reseller, providing the reseller with an opportunity to winback [sic] the customer. Second, there are a number of nonrecurring charges associated with Centrex that can make it very expensive for customers to switch back to USWC. In sum, once we lose a customer, it is very difficult to win that customer back.

Other Potential Solutions

The following proposes some near-term actions we believe USWC must consider taking in order to compete against Centrex resellers in Washington.

- Enhance the perceived value of the 1FB/FL by packaging vertical services and/or improving service levels (e.g., installation, repair, etc.) for small business customers within competitive areas. The objective would be to make it difficult to directly compare a resold Centrex to 1FB/FL service.

- Increase perceived switching costs of 1FB/FL customers through loyalty programs (e.g., discounts on toll, internet access, office products).

- If Centrex grandparenting is unsuccessful, open Centrex Plus for sale by our sales teams and agents to slow market share erosion.

- Augment previous small business channel training with new information that will improve our ability to effectively handle situations where we are competing against resold Centrex. Our representatives must be able to highlight reasons why customers should not switch to a Centrex-based service (e.g., by explaining how competitors use NARS and the associated potential for blocking).

- Eliminate existing barriers to switching back to USWC by requiring reciprocal number portability and allowing for waiver of nonrecurring charges in competitive winback [sic] situations.
- Improve small business account coverage in key markets. (We are initiating a plan that will create a "virtual" Eastern Washington team that will improve account coverage in Spokane.)

These are a few of our ideas. We are anxious to couple these with the initiatives you have introduced in Iowa so that we can stem the loss in Washington.

[CONFIDENTIAL]

CENTREX PLUS SERVICE DESCRIPTION

Revision 3.2

September 10, 1991

D.C. Hruska

206-345-3260

PRIVATE AND CONFIDENTIAL

Intended for use by authorized employment of U.S. West Communications only.

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Appendix

Attachments

Revision Changes

1. Spelling and typo corrections.
2. Rate Structure, page 12

   Addition of Airline milage statement.
3. Rate Structure, page 12: Matrix Structure

   Addition of 84 month parameter to longest contract period.
4. Location Definition, page 8

   Addition of common ownership clause.
5. Compensation, page 15

   Addition of compensation policy statement.

CENTREX PLUS PRODUCT DESCRIPTION

COPY 1
REVISION 3.2
DATE 9-10-91

The intent of the following document is to provide Centron Product team members with a detailed description of the new product to be offered in the US West Centron family. The issues to be addressed in this document will provide

team members with both philosophical and logistical reasoning for product packaging and support related issues.

This document will change as decisions are made by upper management and as operational issues are identified by team members. Revisions will be sent with revised text and highlighted outline identifying changes as issues are resolved. Please ensure that your team is working from the current revision. As your team identify [sic] issues that may require a change in product structure, please notify D.C. Hruska (206-345-3260).

INTRODUCTION

Currently in the 14 states of US West the Centron family of switched central office services is offered in no less than 10 variants. Each offering is slightly different and each is targeted at some segment of the market for this product. The offerings range from fully tariffed services, through a combination of tariff and custom priced offerings, to fully custom built and priced services. Service packages differ in each product reflecting different philosophies of product design and implementation. Access from Centron services to the network is generally limited to two offerings, either line rated (100% access) or trunk rated (engineered access), but exceptions to these two methods can be found in various states. Treatment of "CALC" is different by region and in some cases by product. Provisioning for the product is not well documented, and is often reflective of specific switch environments. The overall quality of provisioning, including assignment, translation, billing and repair is sub-standard.

For these reasons, among others, the new product is being introduced. The intent of the new product is to offer a consistent, 14 state approach to the packaging, pricing and provisioning of Centron type services. Consistency in service components will ease the burden of provisioning, and should serve to make those who must deal with provisioning issues more confident and better skilled at installing and maintaining the new service. The goal of the new product is to remove all barriers to providing quality product, while retaining the flexibility required by customers in the market place. It is the intent of the Centron Product management group to use this new product to replace the current variations available under the Centron name, and to use this new product as the platform for future enhancements.

The new product will also provide for a consistent and non-discriminatory approach to pricing. Arbitrage of existing US West products will be limited if not eliminated. The focus of the new product will be to offer competitive, fully featured, expandable and flexible service for customers who's [sic] business needs play to the strengths of a network based solution.

The new product will offer a number of new concepts in packaging and in service offering. It will depart from some of the traditional thinking on central office based services, and will seek to combine network elements in an effective and competitive manner.

Finally, this product will be made available, via filings in various jurisdictions, beginning in September 1991. All states will be [sic] receive filing packages prior to December 31, 1991.

EXHIBIT A

December 20, 1991

Advice No. 2254T

Office of the Secretary
Washington Utilities and
Transportation Commission
P.O. Box 9022
Olympia, Washington 98504-9022

Dear Mr. Curl:

US West Communications, Inc. (USWC) is forwarding for filing the sheets listed on Attachment A.

This filing introduces distance sensitive contracted pricing options for Private Line services. This filing proposes to achieve a consistent pricing structure among similar services, and provides USWC with the ability to effectively compete in local transport markets.

The Centrex Plus price list, the Station Message Detail Recording to Premise (SMDR-P) price list and the business Complex Lines tariff are being filed concurrently with this filing and with the same effective date of February 14, 1992. Advice No. 2251T introduces distances sensitive contracted pricing options for business Complex Lines.

This filing is designed to:

1) Meet customer needs by offering rate stability and discounts to customers who sign contracts for Analog Private Line services.

2) Provide a consistent pricing structure among similar services, and

3) Provide equitable pricing in the Private Lines business market.

The ability to provide customers with a discount which more closely correlates to the costs of providing service, is necessary for USWC, in order to be competitive in the marketplace. Discounts also provide added incentive many customers need to sign a long term contract for these services. Optional offerings are made available to customers of these services who meet minimum qualifications outlined in the terms and conditions of the tariff.

The contracted pricing structure for Private Line services is sensitive to contract length and number of lines or circuits to a location. The proposed contract incorporates the pricing strategies utilized in the Centrex Plus price restructure price list.

The estimated annual revenue effect for Private Lines is a negative $515,000.

Provided under separate cover is supportive information which is confidential to US West Communications.

Yours very truly,

ORIG. SIGNED BY
By M.D. MORAN
Vice President

Attachments

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[ER 00960]

[CONFIDENTIAL]

Q. Why are you trying to destroy resellers.

A. Resellers have a place when they bring added value to a service. If they add nothing more than what USWC already provides and simply through aggregating customers bring the same service at lower prices than the general body of ratepayers (both residence and business) are hurt.

The Commission has ruled that resale is contrary to the public interest. First user service was not intended to let reseller arbitrage 1FB service or let customers in diverse locations avoid paying regular business rates. By capitalizing on the rate differential between Centrex and 1FB and trunk rates residential and business customers hurt ~~from~~ by the last contribution and therefore resale undermines the policies of the Commission.

U S WEST Communication
1600 Bell Plaza, Room 3105
Seattle, Washington 98191
206 345-2002

Dennis L. Okamoto
Vice President – Washington

USWEST
COMMUNICATIONS [LOGO]

February 17, 1995

Advice No. 2617T

Office of the Secretary
Washington Utilities and
Transportation Commission
P.O. Box 47250
Olympia, Washington 98504-7250

Dear Mr. McLellan:

U S WEST Communications, Inc. (USWC) is forwarding for filing the sheets listed on Attachment A.

This filing rebalances USWC rates and eliminates or significantly reduces existing subsidies that cannot be maintained in a competitive marketplace. Rate increases are phased-in over four years beginning March, 1995 with subsequent annual increases. Rate decreases are phased-in over two years and are effective at the same time as the rate increases. The phase-in rate approach has been planned by the Company to provide a transition for affected customers and at the same time recognize the Company's urgent need to respond to competitive pressures.

The rates to become effective in 1995 have an annual revenue effect of $95,301,836. The rates to become effective in 1996, 1997 and 1998 have an annual revenue effect

of $22,602,847, $46,785,542 and $39,923,697 respectively for a total revenue effect of $204,613,922 after four years. The rates increase Washington intrastate operating revenues over 1994 levels by 10% in 1995. The Company's revenue requirement of $326 million is well in excess of the rate relief requested; the Company is asking only to recover 63% of that amount at this time.

The tariffs increase rates for residence basic exchange access, directory assistance, private line network access channels and miscellaneous discretionary services. Message toll service, private line mileage rates, switched and special access and local interconnection service rates are reduced. Rates for business basic exchange access and private line are changed such that some customer rates increase while other customer rates decrease. A late payment charge is also introduced.

By separate letter, the Company is filing price list revisions for Centrex Plus and miscellaneous discretionary services.

The Company has today prefiled with the Secretary of the Commission, testimony and exhibits in support of the tariff changes described above. All requirements of WAC 480-09-330 have been satisfied.

The Company's urgent need to improve its earnings and rebalance its rates in the emerging competitive environment requires an expeditious processing of this case. It is our intent to request an expedited schedule similar to that just mandated in Docket No. UT 941465, the interconnection tariff proceeding, because of a like need to quickly resolve the critical issue presented. We request that the Commission additionally schedule an early prehearing conference to discuss the possibility of a mediated alternative

dispute resolution process designed to resolve insofar as possible the issues that cut across this proceeding, the interconnection proceeding, and the company's proposed AFOR in Docket No. UT-931347. The principles for alternative dispute resolution stated in the Commission's Policy Statement of December 23, 1994 in Docket No. A-940351 are ideally suited for application to the critical public policy issues presented for resolution in these three U S WEST proceedings.

If you have questions concerning this filing, please contact Theresa Jensen on (206) 345-4726.

Yours very truly,

By /s/ Theresa A. Jensen
for Vice President

Attachments

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[ER 01103]

times as much as it charges other similarly situated single customers. Metronet contends that, if the Commission accepts USWC's and staff's recommendations to lower business line rates before fully implementing the goals of the Centrex Plus Order, USWC competitors will likely be eliminated before a viable wholesale product exists for them. Under those proposals, Metronet contends that it would not break even charging the proposed rate until it had about 200 lines in a single central office. Metronet recommends revising the Centrex rate table to provide volume discounts based on the total number of NACs in the customer's system, regardless of location, and to revise the tariff to eliminate the requirement that the customer purchase a feature package for each NAC.

Enhanced Telemanagement, Inc. (ETI) argues that there is no need to relitigate the formula for aligning Centrex rates with private line NACs, NARs and PBX trunks. This formula is consistent with the Telecommunications Act's mandate to incumbents to offer resale of services. ETI contends that USWC's attempt to freeze Centrex service demonstrates that Centrex service is not competitive. It urges the Commission to reject USWC pricing proposals that would upset the existing Centrex Plus case formula.

TRACER and DIS believe the Commission should adhere to past orders where it found that the highest priced Centrex Plus station line should be set at the price

of a private line NAC. The Commission should reduce the station lines to $7 (the private line NAC price proposed by DIS) and adjust the price of other Centrex Plus station lines accordingly (Ex. 790-T, 7) The best available revenue impact estimate is a decrease of $11,405 supplied by Commission Staff. (Ex. 608)

The Commission finds that the existing arrangements are discriminatory and in practice they operate to benefit the Company. The Commission accepts Metronet's argument that it is high time for the Commission to order the Company to take the steps it encouraged the Company to take in the Centrex Plus compliance filing order.[68] The order and its predecessor[69] were clear in their terms and in their import. The Commission accepted a filing that fell short of perfection but enjoyed substantial agreement among most parties – excluding Metronet – and because it was a step in the direction ordered by the Commission. Now in this filing the Company has proposed measures that would regress from the imperfect arrangements now in effect.

The Company shall file tariffs effecting the unbundling of the Centrex elements, pricing the highest Centrex Plus station line at the private line NAC rate, and remove the station location requirement. Doing so is consistent not only with both of the Centrex Plus orders cited above

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[68] Sixth Supplemental Order, Docket Nos. UT-911488, 911490 and 920252 (Dec. 1994)

[69] Fourth Supplemental Order, Docket Nos. UT-911488, 911490 and 920252 (Nov. 1993).

but also with the federal requirement requiring resale and unbundling.

* * *

US West Communications
1600 Bell Plaza, Room 3204
Seattle, Washington 98191
206 345-2002

C. Scott McClellan
Vice President - Washington

April 18, 1997

Transmittal No.2858L

Office of the Secretary
Washington Utilities and
Transportation Commission
P.O. Box 47250
Olympia, Washington 98504-7250

RE: Price List Changes

Dear Mr. McLellan:

US WEST Communications, Inc. (USWC) is forwarding for file the sheet listed on Attachment A. This is a revision to the Washington Exchange and Network Services Price List, Section 9, Central Office Services.

This filing reinstitutes the location assessment of the Centrex Plus Feature Package rates to a location specific basis rather than on a per system basis. This filing is in accordance with the Twenty-Third Supplemental Order of the Washington Utilities and Transportation Commission, in Docket No. UT-950200, dated February 20, 1997, where the Commission stated that the changes that were directed to Centrex tariff elements are for all practical purposes revenue neutral within the tariff and that it was the Company's decision to reduce the price of the feature package.

If you have questions concerning this filing, please contact Joyce Morris on (206) 345-5921.

Yours very truly,

By /s/ Theresa A. Jensen for
Vice President

Attachments

Attachment A
Transmittal No. 2858L

EXCHANGE AND NETWORK SERVICES
PRICE LIST

SECTION	SHEET	REVISION
9	35.1	1st

US WEST COMMUNICATIONS, INC.

Price List
Washington

SECTION 9
1st Revised Sheet 35.1
Cancels Original Sheet 35.1

EXCHANGE AND
NETWORK SERVICES

9. CENTRAL OFFICE SERVICES

9.1 Dial Switching Systems
9.1.16 Centrex Plus Service
D. Rates and Charges – Common Switching Elements (Cont'd)

	USOC	NONRECURRING CHARGE	MONTHLY RATE
2. Common Equipment[1]			
• Centrex Plus common equipment per system	HYE	$ 125.00	$ 40.00
• Split service common equipment, each customer group	HYS	125.00	40.00
3. Additions or changes for subsequent installation of one or more Standard or Optional Features to a station line	REAFM	6.25	–

4. Standard Feature Package, per service address location (C)

   a. Month-to-Month Standard Feature Package, per main station line, extension station line, each [2]

THE FOLLOWING RATES ARE EFFECTIVE FEBRUARY 20, 1997. BEFORE THIS DATE, SEE SHEET 35.

	USOC	MONTHLY RATE
• Centrex Plus common equipment per system	SFJXM	$ 11.00
• 21-50 station lines, each	SFJXM	11.00
• 51 and over station lines, each	SFJXM	11.00

[1] Rates and charges are in addition to all other applicable charges for each main or extension station line.

[2] Requires a Centrex Plus Network Access Channel as found n9.1.16 of the Exchange and Network Services Tariff.

BEFORE THE WASHINGTON UTILITIES
AND TRANSPORTATION COMMISSION

In the Matter of the Petition of:	
PACIFIC NORTHWEST BELL TELEPHONE COMPANY,	CAUSE NO. U-86-34
for Classification of the Following Services as Competitive:	CAUSE NO. U-86-35 CAUSE NO. U-86-36
(1) INTRACALL SERVICE,	CAUSE NO. U-86-86
(2) SPEED CALLING SERVICE,	
(3) SCAN ALERT SERVICE,	
(4) CENTREX-TYPE SERVICES	
• • • • • • • • • •	
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,	CAUSE NO. U-86-90
Complainant,	FOURTH SUPPLEMENTAL ORDER
vs.	
PACIFIC NORTHWEST BELL TELEPHONE COMPANY,	(Service Date Apr.7, 1987)
Respondent.	
• • • • • • • • • •	

PROCEEDINGS: Pacific Northwest Bell Telephone Company filed petitions for classification of several services as competitive pursuant to RCW 80.36.330 (Section 5 of Chapter 450, Laws of 1985). Those services included Intracall Service, Speed Calling Service, Scan Alert Service, and certain elements of Centrex-type Services. Respondent also filed tariff revisions designed to raise six

tie line termination rate elements and to reduce the rates on certain other elements.

HEARINGS: Hearings where [sic] held before Chairman Sharon L. Nelson, Commissioners Robert W. Bratton and Richard D. Casad, and Administrative Law Judges Alice L. Haenle, Rosemary Foster, and Elmer Canfield of the Office of Administrative Hearings. Hearings were held on August 11, October 21 and 22, December 15 and 16, 1986, and February 9, 1987, at Olympia, Washington. Clarifying proceedings were held on September 15 and 16, 1986. Testimony from members of the public was taken on December 19, 1986, at Seattle, Washington.

APPEARANCES: Pacific Northwest Bell Telephone Company was represented by Lawrence E. Sarjeant and Corey K. Ford, Attorneys at Law, Seattle, and by Richard Hemstad, Attorney at Law, Olympia. The staff of the Utilities and Transportation Commission was represented by James R. Cunningham and Donald T. Trotter, Assistant Attorneys General, Olympia. The public of the State of Washington was represented by Charles F. Adams and Robert F. Manifold, Assistant Attorneys General, Public Counsel Section, Seattle. Intervenor State of Washington Department of General Administration, Division of Telecommunications (GA), was represented by Robert V. Jensen, Assistant Attorney General, Olympia. Intervenor American Network, Inc. (AmNET) was represented by William R. McInerney, Jr., Attorney at Law, Seattle, and by Deborah Harwood, Attorney at Law, Vancouver, Washington. Intervenor Washington Telecommunications Ratepayers Association for Cost-Based and Equitable Rates (TRACER) was represented by Arthur A. Butler, Attorney at Law, Seattle. Intervenor U.S. Sprint Communications Company (US Sprint) was represented by

Frederick A. Morris and John Daniel Ballbach, Attorneys at Law, Seattle, and by Craig D. Dingwall, Attorney at Law, Burlingame, California. Intervenor AT&T Communications was represented by Daniel Waggoner, Attorney at Law, Seattle. Intervenor MCI Telecommunications Corporation (MCI) was represented by Clyde H. MacIver and Brooks E. Harlow, Attorneys at Law, Seattle, and by William Levis, Attorney at Law, Denver, Colorado.

SUMMARY: The Commission classifies as competitive Intracall Service, Speed Calling Service, and Centrex-type Services. The Commission denies the petition to classify as competitive Scan Alert Service, based on lack of effective competition in the market. The Commission further accepts the tariff filings regarding tie line terminations.

I. PROCEDURAL HISTORY

Pacific Northwest Bell Telephone Company (hereinafter referred to as PNB, company, or petitioner) filed the following petitions. On March 11, 1986, PNB filed petitions to classify as competitive telecommunications service its Intracall Service (Cause U-86-34) and its Speed Calling Service (Cause U-86-35).

On March 18, 1986, PNB filed a petition to classify as a competitive telecommunications service its Scan Alert Service (Cause U-86-36). On May 30, 1986, PNB filed a petition for classification as competitive telecommunications services certain elements of its central office services (hereinafter Centrex-type Services)

(Cause U-86-86). PNB also filed on May 28, 1986, a petition to have classified as competitive telecommunications services private-line transport services (Cause U-86-85).

By order issued June 10, 1986, all five of these petitions for classification were consolidated for hearing and determination.

On May 28, 1986, PNB filed revisions to Tariff WN U-14 (UTF 211) to raise six tie line termination rate elements and to reduce rates on Centrex Touch-Tone and Centrex call transfer services. This was designated Cause U-86-90. The company represented that the effect of these filings would be revenue-neutral. A complaint and order suspending the operation of tariff revisions was issued on June 9, 1986. On June 25, 1986, a First Supplemental Order Instituting Investigation was issued.

Also on May 28, 1986, PNB filed revisions to Tariff WN U-14 and new Tariff WN U-20, relating to private line trans-port services (Cause U-86-89). A complaint and order suspending operation of tariff revisions was issued on June 10, 1986. A First Supplemental Order Instituting Investigation was issued on June 25, 1986.

By Second Supplemental Order issued on July 21, 1986, Cause Nos. U-86-89 and U-86-90 were consolidated for hearing and determination.

Initial hearing sessions were held on August 11, 1986, regarding both the five consolidated petitions for classification and the two consolidated tariff revision filings. After taking argument at that hearing session from the parties, the Commission issued its Third Supplemental Order on August 20, 1986. The order granted PNB's motion to withdraw the two causes relating to private-line transport

services (Causes U-86-85 and U-86-89). The Commission also consolidated for hearing and determination the remaining causes, Cause Nos. U-86-34, U-86-35, U-86-36, U-86-86, and U-86-90.

Hearings were held on August 11, October 21 and 22, and December 15 and 16, 1986, and on February 9, 1987, at Olympia, Washington. Clarifying proceedings were held on September 15 and 16, 1986. A hearing for the purpose of taking testimony from members of the public regarding these consolidated causes was held on December 19, 1986, at Seattle, Washington. Two members of the public appeared and testified.

Briefs were received on March 2, 1987.

II. PETITIONS FOR CLASSIFICATION

A. Description of Services

1. Intracall Service

This service permits a single telephone line to be used as an intercom system by means of communications between multiple stations on the same line. The service is currently limited to single-party lines served by PNB central offices equipped with 1AESS electronic switching systems programmed with the necessary central office software.

2. Speed Calling Service

Speed Calling Service permits a customer to dial frequently-used telephone numbers more quickly by dialing one or two digits instead of the entire telephone number. The customers can program from 7- to 15-digit

telephone numbers, which may be local or long distance. To dial these pre-programmed numbers, the customer then presses the speed calling digits assigned far the number stored in the speed call memory. The service is currently limited to PNB customers served from its central offices equipped with electronic switching equipment.

3. Scan Alert Service

Scan Alert is PNB's alarm signal transport service which allows the monitoring of a change in the status of an alarm or other type of warning sensor provided by a participating alarm company and located on the customer's premises. PNB provides a scanning device in its central office which checks for the presence of tone on the subscriber's exchange line. When an absence of tone is detected, the scanner interrogates reporting equipment at the subscriber's premises for the status of the subscriber's alarm system. The reporting equipment generates an identification number and status report which is then routed to the alarm company. Scan Alert will operate even when the subscriber's telephone line is in use or has been cut or interrupted. Scan Alert is currently offered only from central offices servicing the Seattle and Vancouver areas or central offices that have been equipped to provide this service.

4. Centrex-Type Services

PNB petitioned to have declared competitive the intercom and optional features elements of its seven Centrex-type Services. Centrex-type Services are provided by means of PNB central office switching equipment,

feature software capabilities, and the loop between a central office and the customer's premises.

The seven Centrex-type Services include Centrex Service, Group Use Service (similar to Centrex, but limited to airports, medical complexes, and governmental agencies), Centraflex 1, Centraflex 2, Centraflex 3, Centraflex 4, and Centron. Of these services, Centrex, Group Use, Centraflex 3 and Centraflex 4 are no longer offered to new customers.

B. Standards for Evaluating Petitions

The Regulatory Flexibility Act became effective July 28, 1985. Section 5 of the Act has been codified as RCW 80.36.330. That statute provides as follows:

> 80.36.330 Classification as competitive telecommunications companies, services – Effective competition defined – Prices and rates – Reclassification. (1) The commission may classify a telecommunications service provided by a telecommunications company as a competitive telecommunications service if it finds, after notice and hearing, that the service is subject to effective competition. Effective competition means that customers of the service have reasonably available alternatives and that the service is not provided to a significant captive customer base. In determining whether a service is competitive, factors the commission shall consider include but are not limited to:
>
> (a) The number and size of alternative providers of services;

(b) The extent to which services are available from alternative providers in the relevant market;

(c) The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms, and conditions; and

(d) Other indicators of market power, which may include market share, growth in market share, ease of entry, and the affiliation of providers of services.

(2) When the commission finds that a telecommunications company has demonstrated that a telecommunications service is competitive, the commission may permit the service to be provided under a price list effective on ten days notice to the commission and customers. The commission shall prescribe the form of notice. The commission may adopt procedural rules necessary to implement this section.

(3) Prices or rates charged for competitive telecommunications services shall cover their cost. The commission shall determine proper cost standards to implement this section, provided that in making any assignment of costs or allocating any revenue requirement, the commission shall act to preserve affordable universal telecommunications service.

(4) The commission may investigate prices for competitive telecommunications services upon complaint. In any complaint proceeding initiated by the commission, the telecommunications company providing the service shall bear the burden of proving that the prices charged cover cost, and are fair, just, and reasonable.

(5) Telecommunications companies shall provide the commission with all data it deems necessary to implement this section.

(6) No losses incurred by a telecommunications company in the provision of competitive services may be recovered through rates for noncompetitive services. The commission may order refunds or credits to any class of subscribers to a noncompetitive telecommunications service which has paid excessive rates because of below cost pricing of competitive telecommunications services.

(7) The commission may reclassify any competitive telecommunications service if reclassification would protect the public interest.

Evidence submitted by the parties address the preceding standards. Positions of the parties regarding each of these elements will be outlined below.

C. Positions of the Parties

1. Intracall Service

(a) PNB

PNB contended that Intracall Service is subject to effective competition within the broader market for intercom systems which permit internal communication between different locations within a residence or business. PNB provided evidence that intercom equipment is widely available through suppliers and retail outlets, that there are no barriers to entry in this market, and that PNB has no significant captive customer base for this product. PNB offered a market survey to demonstrate that it had a 0.8 percent to 1.4 percent share of the residential market and

a 0.16 percent to 0.18 percent share of the business market. The current tariff rate is $1.50 per month, compared to a cost of $0.34593.

(b) Commission Staff

The Commission staff recommended on brief that the Commission grant this petition as filed, on condition that the use of PNB's cost studies would not serve as a general approval of PNB's incremental cost studies. While expressing concern that the incremental cost studies might understate costs, the Commission staff also indicated that the amounts by which PNB's incremental cost studies might understate costs were sufficiently small in this filing so as to preclude any significant concern that captive ratepayers would be harmed. Absent the condition that the Commission not generally approve the PNB cost studies, the Commission staff contended that the petition should be denied.

(c) Public Counsel

Public counsel did not take a position on brief regarding this issue.

(d) Intervenors

Intervenors TRACER and G.A. took no position on brief. No other intervenors stated positions on this issue.

2. Speed Calling Service

(a) PNB

PNB contended that Speed Calling Service is subject to effective competition within the market for speed dialing products and services. PNB listed functionally equivalent and substitute products as enhanced telephones and adjunct dialers. PNB contended that there are no barriers to entry into this market and further contended that PNB has no captive customer base for the service. PNB presented evidence that speed dialing. equipment is widely available through suppliers and retail outlets. PNB's monthly tariff for Speed Calling is $2.45 for residence and $2.80 for business customers for 8 – number capacity, compared to its monthly cost of $.20. Its tariff price for 30 – number capacity $5.25 for residence and $5.55 for business service, compared to its cost of $.32.

(b) Commission Staff

The Commission staff recommended on brief that the Commission grant the petition as filed on the condition that the use of PNB's cost studies not serve as general approval of PNB's incremental cost studies. While expressing concern regarding understatement of costs, the Commission staff contended that the understatement in this case would be sufficiently small so as to preclude any substantial harm to captive ratepayers. The Commission staff recommended that the petition be denied if this condition were not attached to the granting of the petition.

(c) Public Counsel

Public counsel did not take a position on this issue on brief.

(d) Intervenors

Intervenors TRACER and G.A. did not take a position on this issue on brief. No other intervenors took positions on this issue.

3. Scan Alert Service

(a) PNB

PNB contended that Scan Alert is subject to effective competition, is priced above its cost, and should be detariffed. PNB described the relevant market as the "monitored security system market". PNB included evidence regarding alternative providers of services, including various technologies and systems for monitored security systems for the protection of persons and property in business and residential settings. Substitute services described by PNB included digital dialers, private-line data channels, central office scanning equipment, COMMONWATCH (using digital dialer technology and adding line security), two-way dedicated cable networks, long-range radio frequency transmission of alarm signals, and satellite transmission of alarm signals.

Defining the market as monitored security systems, PNB contended that Scan Alert comprises less than 1 percent of the market. PNB further contended that there are no barriers to entry into the market as defined, and that PNB has no captive customer base. The tariff fee is $45 installation charge and $6 per month. PNB calculated

the cost to provide the service as $40.91 for installation and $3.88 per line per month.

On rebuttal, PNB challenged the analysis of staff witness Dr. Cornell. Dr. Cornell defined the market as the transmission of alarm signals between customers' premises and alarm companies. PNB stressed that Scan Alert is a feature separate from the customer's basic residence or business line, as any feature is separate. *PNB* stressed that there is no bundling with basic service. *PNB* concluded that Scan Alert is subject to effective competition, is priced above cost, and should be detariffed.

(b) Commission Staff

The Commission staff recommended this service not be classified as competitive. The recommendation was based on Dr. Cornell's definition of the relevant market as the transmission of alarm signals between customer premises and alarm companies. Using this definition of market, the Commission staff contended that PNB has a 99 percent market share. The Commission staff concluded that this service was not subject to effective competition. This conclusion was based on the lack of alternative providers of alarm signal transmission capacity and PNB's ability to manipulate prices to affect consumer choices. The Commission staff contended that by manipulating the rates charged for Scan Alert and private lines, PNB would be able to determine which form of alarm system would dominate the market. By pricing Scan Alert so that the extra cost to consumers of its transmission was low enough, the benefits of the security of a secured line would make customers switch from automatic dialers to Scan Alert.

The Commission staff concluded that Scan Alert should not be classified as competitive.

(c) Public Counsel

Public Counsel did not address this issue on brief.

(d) Intervenors

Intervenors did not address this issue on brief.

(4) Centrex-Type Services

The petition to classify as competitive certain features of Centrex-type services presents significant issues in this proceeding. The testimony and legal arguments presented by the parties primarily address two issues. The first is whether Centrex-type services are subject to effective competition. The second general area of issues involves cost standards and cost studies, both for analysis of whether prices of Centrex-type services cover their cost and also to guarantee that losses incurred by a telecommunications company in the provision of competitive services are not recovered through rates for non-competitive services, pursuant to RCW 80.36.330(6). The presentations of the parties with regard to these specific areas will be discussed in the following section.

(a) PNB

PNB contended that Centrex-type services are subject to effective competition and are priced substantially above their cost.

PNB defined the relevant market as the market for custom features for basic telephone services. PNB indicated that Centraflex 1 and Centraflex 2 compete with simple telephone sets and key systems, while Centrex, Centraflex 3, Centraflex 4 and Centron compete with PBXs. PNB described the availability of alternate technologies for custom features, including customer premises equipment such as key systems, PBXs and hybrid PBXs (blending key system and PBX technology). Custom features are also offered by local exchange carriers through central offices. Because of the reasonably-available alternatives described above, PNB concluded that it has no captive customer base. PNB estimated that Centrex-type services comprised 13 percent of the market as defined. PNB concluded that the statutory standard demonstrating effective competition had been met.

PNB filed Long Run Incremental Cast (LRIC) studies for each of the products. PNB contended that incremental cost was the appropriate method for use, both in determining the price floor under RCW 80.36.330(3) requiring that competitive services recover their costs, and for assuring that noncompetitive services do not subsidize competitive services pursuant to RCW 80.36.330(6).

PNB also submitted an accounting plan which it is developing for the Oregon Commission, a 1985 embedded cost study and a 1984 RCAS study for comparison and corroboration of of the results indicated by the LRIC study. PNB concluded that the services are priced above their cost and that the statutory requirements with respect to cost have been met.

(b) Commission Staff

The Commission staff recommended that the petition for classification be denied because of price discrimination and because of problems with costing methodology.

The Commission staff witness Dr. Cornell contended that the ability of PNB to charge two customers a different price for the same item, that is, lines to the local exchange switch, depending upon whether the user is a Centrex user or a PBX user, prevents effective competition. In order to have effective competition, all monopoly service elements must be available to PNB's customers and its competitors on the same terms and conditions. The Commission staff further contended that PNB's ability to engage in price discrimination in the pricing of these lines creates barriers to entry into the market. The Commission staff further contended that PNB has already acted on the incentive to discriminate against competitors, comparing the price charged for a line to a Centraflex 3 customer and to a PBX customer in Exhibit 80. The Commission staff therefore recommended that the petition be denied until such time as PNB unbundles its rates and offers monopoly services at prices that do not differ depending on the identity of the purchaser of the services.

The Commission staff also disputed the incremental cost study standard proposed by PNB in support of this petition. Staff witness Dr. Cornell concluded that the use of incremental cost studies would not meet the statutory requirement that monopoly ratepayers not subsidize competitive offerings, pursuant to RCW 80.36.330(6). Dr. Cornell criticized the company's studies on three bases. First, PNB has an incentive to understate incremental costs. Second, there is no mechanism to require that PNB

adhere to those cost estimates. Third, incremental cost estimates rely on estimates whose accuracy cannot be assured. Dr. Cornell therefore recommended that a fully-allocated cost standard be designated as the appropriate methodology.

Dr. Cornell further disagreed with the manner in which PNB had conducted its cost studies, on several grounds. First, the studies were based on the wrong type of switch. Second, PNB did not attempt to demonstrate that its conduct satisfied the conditions under which a marginal cost standard might offer benefits, that is, that the last unit of output is produced in the most efficient manner. Third, PNB did not attempt to differentiate the cost of capital component of its studies to account fo the higher risk of a competitive environment. Fourth, the studies were not based on randomly-sampled data. Fifth, in most cases the wrong population was sampled. Sixth, the studies were based on some improper assumptions. Seventh, the studies failed to allocate common costs, resulting in an understatement of Centrex costs.

The Commission staff also urged rejection of studies performed by Mr. Hudson on behalf of the company and by Dr. Zepp of [sic] behalf of TRACER.

(c) Public Counsel

Public counsel's witness Dr. Kahn recommended that the Commission should establish a minimum revenue requirement for the category of detariffed services, which should be established using stand-alone cost procedures. Dr. Kahn further urged that PNB be provided wide discretion in establishing prices of the individual products deemed competitive and detariffed.

Dr. Kahn recommended the stand-alone methodology as having three properties. First, each service and body of services should be responsible for recovering all costs it causes to be incurred. Second, all services should benefit from the economics resulting from joint production. Third, cost allocations should properly reflect investment planning criteria.

Dr. Kahn contended that a stand-alone cost study is a practical alternative, although the methodology was criticized by other parties. On brief, public counsel cited a number of other jurisdictions which have begun investigation of this type of methodology. Public counsel suggested that if the Commission ordered a stand-alone cost study, PNB could be allowed to detariff the service on a interim basis pending the gathering of necessary cost support.

(d) Intervenors

Intervenor TRACER supported the granting of this petition for classification. TRACER on brief indicated that, although the potential exists for anticompetitive price discrimination by PNB, the evidence did not indicate that a significant problem exists at this time. TRACER's witness recommended that a two-part test be used when dealing with a bundled service: first, that the competitive service elements cover their costs; second, that the monopoly service elements cover their costs. Dr. Zepp contended that this two-part test would prevent subsidization by monopoly ratepayers.

TRACER's witness Dr. Zepp also recommended that the Commission adopt the long-run incremental cost study as the appropriate standard to be met to satisfy the requirements of the Act. Dr. Zepp further recommended

that, where the revenues that would be generated by pricing all services on the basis of LRIC exceed the revenue requirements of the company, PNB should be permitted to drop its prices for the competitive services to the. fully distributed cost. Dr. Zepp adjusted PNB's estimates of current cost with regard to an inflated carrying charge and by using a lower cost of capital figure for calculation of costs to be used at the cost floor for detariffed services.

Intervenor GA recommended that the intercom feature elements of Centrex services be considered competitive with a wide variety of PBX premise-based switching equipment. On brief, the GA questioned whether it was necessary to deny Centrex a competitive service classification to achieve the goal of development of an alternative to PNB's incremental cost methodology.

Other intervenors did not address this issue on brief.

D. Commission Discussion and Decision

After evaluation of the record and the parties' positions regarding each of the petitions, the Commission has determined that the petitions for classification of Intracall service, Speed Calling service, and Centrex-type services should be granted. The petition for classification of Scan Alert Services should be denied. Discussion and decision regarding each of the services will be set forth separately below.

1. Intracall Service

The Commission notes that the parties expressing a position on the subject supported classification of Intracall

service as competitive. PNB presented evidence to demonstrate there are reasonably available alternatives for intercom services. The Commission concludes that the service is subject to effective competition within the relevant market. There is no evidence of a captive customer base.

As more fully discussed in paragraph II(D)(4) below, the Commission does not specifically accept any of the cost studies presented. Classification of Intracall services as competitive should therefore not be construed as accepting the company's primary LRIC study, or any of its other studies offered on rebuttal.

2. Speed Calling Service

The parties that took a position on the issue also supported classification of Speed Calling service as competitive. The Commission concludes that evidence demonstrates there are reasonably-available alternatives, including enhanced equipment and autodialing devices. The service is subject to effective competition within the relevant market. There is no evidence of a captive customer base.

As more fully discussed in Section II(D)(4), the Commission does not specifically accept any of the cost studies presented. Classification of Speed Calling service as competitive should not be construed to endorse PNB's primary LRIC study or any of the studies offered on rebuttal.

3. Scan Alert Service

The parties to this matter differ in their definition of the product market to be used in evaluating whether effective competition exists. The record shows that a primary feature of Scan Alert is line security, allowing it to operate regardless of whether the subscriber's telephone line is in use or has been cut. As described in the company's testimony, Scan Alert service requires that the subscriber obtain an alarm sensor from an alarm company which has elected to use PNB's Scan Alert system. Of the types of technologies for monitored security systems described by the company, only private-line data channels, which involve a private line used exclusively for the transmission of alarm signals, offer the same type of security. Radio transmission or satellite transmission of alarm signals do not appear to be widely available in the state of Washington.

From this evidence, the Commission concludes that the proper market for analysis is the transmission of alarm signals, as described by the Commission staff. In order to have a functionally equivalent system, a competitor would need a separate private line to provide line security. PNB would have control over the rates charged for this private line. The potential exists for PNB to manipulate private line prices to competitors in order to put competitors at a disadvantage. The company and the Commission staff agree that PNB has 99 percent of the market share in transmission of alarm signals between customers' premises and alarm companies.

The Commission therefore concludes that effective competition does not exist regarding Scan Alert Services. The petition should be denied.

4. Centrex-Type Service

After a review of the record, the Commission has concluded that the record demonstrates that Centrex-type services are currently priced above their costs, as required by RCW 80.36.330(3). Although this does not necessarily mean that services will in the future continue to be priced above their cost, the Commission is aware that new approaches are currently being developed for measuring cost. This case includes some long-run incremental cost information and some information regarding fully distributed costs. The Commission is persuaded by the arguments of TRACER that an appropriate measure for the present is long-run incremental cost or fully distributed cost, whichever is lower. In the future, if services are priced below the descriptions of cost contained in this record, additional review might be appropriate.

In the mean time, the Commission will not specifically accept any of the types of cost studies offered. Serious criticisms have been offered of the long-run incremental cost studies performed by PNB. The Commission believes that the "stand-alone" methodology recommended by Dr. Kahn on behalf of public counsel merits further investigation. Concern was raised regarding the cost and feasibility of such a study. The Commission will therefore direct the company and the Commission staff to jointly report within six months regarding the cost of such a study, the action other states have taken with regard to stand-alone cost studies, the uses to which the results of such studies have been put in other jurisdictions, and the time and expense reasonably necessary to perform such a study.

The Commission has some concern that in a competitive era, the Commission needs to be sure that the company is

not discriminating by means of its monopoly over basic transmission. The Commission anticipates that the company will not package together monopoly transmission services with competitive options. The Commission would prefer to see the company moving in the direction of unbundling monopoly and competitive elements as much as possible.

Testimony was given regarding Corecom contracts. It appears that a Commission staff review on a systematic basis should occur to evaluate the potential for the company to engage in unlawful discrimination. The Commission therefore directs the Commission staff to report within six months on the type of review and analysis of such contracts that can take place on a routine basis.

Some parties suggested that the Commission require reporting regarding detariffed services. The Commission has considered this suggestion, but declines to so order at this time. In making this decision, the Commission has considered other protections of the Act. These include the complaint process available to competitors, the power to reregulate, the ability to order refunds, the requirement of the company to produce records, and the deterrent effect of potential treble damage awards under the Consumer Protection Act, RCW chapter 19.86.

III. TIE LINE TERMINATION RATES

A. Description of Tariff Filings

PNB proposed to change the tariffed rate structure of the Centrex, Group Use and Centraflex service tie line termination. The company also purposed [sic] to reduce the Centrex Touch-Tone rate and the Centrex call transfer

rate to offset the revenue increase-resulting from the tie line revision.

Six tie line termination rate elements are being increased. First, Basic Private-Line Termination will increase from $29.00 to $70.00 for Centrex and group use and from $24.80 to $70.00 for all Centraflex services. Second, Basic Senderized Private-Line Termination will increase from $29.00 to $75.00 for Centrex and Group Use and from $24.80 to $75.00 for all Centraflex services. Third, Advanced Senderized Private-Line Termination will increase from $34.00 to $75.00. Fourth, AUTOVON Access Line with multi-level will increase from $45.00 to $70.00 in Centrex. Fifth, AUTOVON Access Line without multi-level will also increase from $45.00 to $70.00 in Centrex. Sixth, miscellaneous trunk termination will increase from $20.00 to $70.00.

Two decreases were proposed. The first would eliminate the Centrex Touch-Tone rate which is currently $1.40, and include the charge in the basic line rate on all Centrex lines. Second is the Centrex call transfer features which are currently $1.50 per line and are being reduced to $.85 per line. These two reductions will affect only Centrex customers.

The company contended that the filing would be revenue-neutral.

B. Issues and Governing Principles

The ultimate determination to be made by the Commission in this matter is whether the rates and charges purposed in the revised tariffs are fair, just, reasonable, and sufficient, pursuant to RCW 80.36.140. RCW 80.04.130

places the burden of proving that a proposed increase is just and reasonable upon any public service company proposing such an increase.

C. Positions of the Parties

Norman L. Baird, Director – Central Office Services and Product Management for PNB, presented PNB's case. He represented there would be no revenue impact on the company.

The increase in tie line termination rates is expected to generate an additional $1.7 million of revenue. The decrease in Centrex Touch-Tone and call transfer would reduce revenues by $1,698,347.00, approximately offsetting the increase. Mr. Baird represented that all rate elements remained above their cost, based on certain cost studies.

The Commission staff recommended that the proposed tariff changes should be granted, on condition that approval of the tariff revisions not constitute general approval of PNB's incremental cost studies. Absent this condition, the Commission staff recommended the filing be rejected. The Commission staff's recommendation was based on the revenue-neutral aspect of the filing and the few number of items involved.

Public counsel did not take a position on this issue on brief.

The only intervenor to address this issue was GA. GA recommended that to minimize the impact of $29,380.00 annual-rate increase expected to affect the Department of General Administration, reduced rates for Touch-Tone and call transfer features should be incorporated into existing

Corecom contracts. This recommendation was based on figures included in the brief of the GA, which were not included in the record.

D. Commission Discussion and Decision

The Commission concludes that the tariff filings should be accepted. As discussed above, this should not be construed to indicate acceptance of the methodologies of cost studies used by PNB. The revenue-neutral nature of this filing indicates that there should be no impact on ratepayers generally.

The Commission is concerned that the GA included facts in its brief which it expected the Commission to consider but which were not included in the record. GA had the opportunity to present a witness regarding its recommendation. It chose not to do so. The Commission declines to interfere in the contract process in the form of altering any of the terms of GA's Corecom contract. The Commission will not consider those elements of the GA's brief which could be characterized as facts rather than legal arguments.

FINDINGS OF FACT

Having heretofore discussed in detail both the oral and documentary evidence concerning all material matters inquired into, and having stated findings and conclusions, the Commission makes the following summary of those facts. Those portions of the preceding detailed findings pertaining to the ultimate facts are incorporated by this reference in the ultimate facts found herein.

1. The Washington Utilities and Transportation Commission is an agency of the State of Washington vested by statute with the authority to regulate rates, rules, regulations, practices, accounts, securities, and transfers of public service companies, including companies providing telecommunication service within the State of Washington.

2. Under the Regulatory Flexibility Act codified in chapter 80.36 RCW, the Commission is empowered, after notice and hearing, to classify a telecommunications service provided by a telecommunications company as a competitive telecommunications service if it finds that the service is subject to effective competition.

3. Pacific Northwest Bell Telephone Company is engaged in the business of furnishing telecommunications services within the State of Washington as a public service company.

4. PNB filed the following petitions for classification:

Case No.	Service	Date
U-86-34	Intracall Service	March 11, 1986
U-86-34	Speed Calling Service	March 11, 1986
U-86-36	Scan Alert Service	March 18, 1986
U-86-86	Centrex-Type Services	May 30, 1986

5. On May 28, 1986, PNB filed revisions to its Tariff WN U-14 to raise six tie line termination rate elements and to reduce the rates on Centrex touch-tone and Centrex call transfer services. This was given U-86-90. The tariff was suspended by Commission order dated June 9, 1986.

6. PNB also filed a petition to have classified as competitive its private-line transport services (Cause U-86-85), and a tariff filing relating to private-line transport

services (Cause U-86-89). These two cause numbers were withdrawn by Pacific Northwest Bell and dismissed by Commission order issued August 20, 1986.

7. The five remaining cause numbers were consolidated by Commission order date August 20, 1986.

8. Hearings were held on August 11, August 21 and 22, December 15 and 16, December 19, 1986 and February 9, 1987. Clarifying proceedings were held on September 15 and 16, 1986.

9. Intracall Service permits an intercom conversation to be carried on between multiple stations on a single-party line. It is subject to effective competition within the market for intercom systems which permit internal communication between different locations within a residence or business. Reasonably-available alternatives in the relevant market include various types of intercom equipment. The equipment is available through a number of alternative providers. There is no significant captive customer base. PNB holds less than a 2 percent share of the relevant market.

10. Speed Calling permits a customer to dial frequently-used telephone numbers faster by dialing only one or two digits instead of the entire telephone number. This service is subject to effective competition in the market for speed dialing products and services including enhanced equipment and adjunct dialers. Alternative services are reasonably available in the relevant market. PNB has no captive customer base.

11. Scan Alert is an alarm signal transport service. The service is not subject to effective competition within the relevant market of alarm signal transport service.

PNB holds approximately 99 percent of the market in transmission of alarm signals between customers' premises and alarm companies.

12. Intercom and optional features elements of Centrex-type services, are subject to effective competition. Customers within the relevant market have reasonably-available alternatives in PBXs, key systems, and hybrid PBXs. Centrex-type services are currently priced above their cost.

13. Findings of Fact 9 through 12 are based upon a consideration of the factors set forth in RCW 80.36.330(1).

14. Additional information regarding stand-alone cost studies would assist the Commission in performing its evaluation of competitive service filings.

15. Commission staff review of Corecom contracts on a systematic basis is necessary to determine whether discrimination is occurring.

16. The tariff revisions filed by respondent in Cause U-86-90 should be accepted. The increase in revenues of $1.7 million will be offset by a decrease in revenues of $1,698,347.

CONCLUSIONS OF LAW

1. The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of this proceeding and parties thereto.

2. The Commission concludes that Intracall, Speed Calling, and the requested elements of Centrex-type services are properly classified as competitive services under the Regulatory Flexibility Act, RCW 80.36.330,

based on the existence of effective competition for these services.

3. The Commission concludes that Scan Alert service is not properly classified as a competitive telecommunications service under RCW. 80.36.330. Effective competition does not exist in the relevant market of transmission of alarm signals

4. The order of suspension in Cause U-86-90 should be lifted. The tariff revisions will result in rates and charges which are fair, just, reasonable, and sufficient.

5. PNB and the Commission staff should be ordered to report jointly to the Commission within six months regarding the feasibility of stand-alone cost studies.

6. The Commission staff should report within six months regarding a systematic review of Corecom contracts to determine whether discrimination is occurring.

7. All motions made in the course of this hearing which are consistent with the findings, conclusions and decisions herein should be granted, and those inconsistent herewith should be denied.

ORDER

WHEREFORE, THE COMMISSION HEREBY ORDERS:

1. The petitions of PNB for classification as competitive services of Intracall, Speed Calling and Centrex-type services shall be, and the same are hereby, granted.

2. The petition of PNB for classification as a competitive service of Scan Alert service shall be, and the same is hereby, denied.

3. The Order of Suspension dated June 9, 1986, in Cause No. U-86-90 shall be, and the same is hereby lifted.

4. PNB and the Commission staff are required to report to the Commission within six months regarding the feasibility of stand alone cost studies.

5. The Commission staff is required to report to the Commission within six months regarding systematic review of Corecom contracts to see whether discrimination is occurring.

DATED at Olympia, Washington, and effective this 7th day of April, 1987.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

/s/ SHARON L. NELSON
SHARON L. NELSON, Chairman

/s/ ROBERT W. BRATTON
ROBERT W. BRATTON, Commissioner

/s/ RICHARD D. CASAD
RICHARD D. CASAD, Commissioner

Chief Judge John C. Coughenour

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

METRONET SERVICES CORPORATION and METRONET TELEMANAGEMENT CORPORATION, Plaintiffs, v. U S WEST CORPORATION, a Colorado corporation, Defendant.	Civil No. C00-0013 C DECLARATION OF NINA W. CORNELL IN SUPPORT OF MEMORANDUM IN OPPOSITION TO MOTION FOR SUMMARY JUDGMENT

Filed Under Seal

Chief Judge John C. Coughenour

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

METRONET SERVICES CORPORATION and METRONET TELEMANAGEMENT CORPORATION, Plaintiffs, v. U S WEST CORPORATION, a Colorado corporation, Defendant.	Civil No. C00-0013 C DECLARATION OF NINA W. CORNELL IN SUPPORT OF MEMORANDUM IN OPPOSITION TO MOTION FOR SUMMARY JUDGMENT (Filed Mar. 5, 2001)

I, Nina W. Cornell, declare and state as follows:

My name is Nina W. Cornell. My address is 1290 Road 4DT, Meeteetse, Wyoming 82433. I am an economist and am self-employed as a consultant. I have been a consultant since 1981, working primarily on telecommunications issues.

Much of my consulting work has involved analyzing issues presented by filings in front of state regulatory commissions, then preparing and presenting testimony containing that analysis, or participating in workshops that have tried to reach consensus on solving particular issues. I have appeared in more than one hundred proceedings, with about a quarter of those being applications by long distance companies for certificates to provide competitive intrastate long distance service in connection with the divestiture by AT&T of its local exchange companies. The rest have concerned primarily issues such as appropriate prices to be charged by incumbent local exchange companies, appropriate regulation for incumbent local exchange companies, and how to measure the costs of providing services by incumbent local exchange companies. I have also been involved with a number of workshops on how to measure costs of services. My testimony has been on behalf of a number of companies that were tying to compete with present or former monopoly companies, on behalf of commission staffs, or on behalf of public counsels.

At least ten of my consulting assignments have involved proceedings before the Washington Utilities and Transportation Commission ("WUTC"). I was the witness for the staff of the WUTC for several of those proceedings. One of those proceedings for which I served as the staff

witness, Consolidated Cause Nos. U-86-34, et al, was the docket opened in response to U S West's request to have several of its services, including its various Centrex services, declared deregulated. A second proceeding for which I served as the staff witness, Docket Nos. UT-911488, et al, involved U S West's proposed restructuring of its rates for access lines supplied as part of Centrex Plus, Complex Business Lines, and private line Network Access Connections (NAC).

One of my first consulting assignments was to serve as a rebuttal witness for the Department of Justice in *U.S. v. AT&T.* My testimony dealt primarily with the inability of regulation to deal with the conduct of AT&T that was the basis for the suit. I have also participated in a number of other antitrust cases, most of which settled before trial.

Prior to becoming a consultant, I served for almost three years as the Chief of the Office of Plans and Policy at the Federal Communications Commission, an office that employed as many as twenty economists, engineers, and lawyers. In that position, I also served as the chief economist for the Commission. My job was to analyze and present to the Commission the economic or other policy ramifications of any proposal before it. During my tenure as the Chief of the Office of Plans and Policy, the federal courts opened the interstate switched long distance market to competition, and somewhere between one half and two thirds of my time was spent on such issues as the appropriate charge for interconnecting competing long distance companies to the incumbent local exchange carrier networks, how to compensate for or eliminate the unequal quality of those interconnections, issues of resale of services of the incumbent long distance provider, and the like. The remainder of my time was spent on issues

involving broadcasting, cable television, spectrum allocation, mobile communications, and international telecommunications.

Prior to joining the staff of the Federal Communications Commission, I served for approximately a year and a half on the staff of the Council of Economic Advisors, part of the Office of the President of the United States. My work at the Council was primarily directed at regulation, mainly environmental, health and safety regulation, but also including regulation of telecommunications. For approximately eight months prior to joining the staff of the Council of Economic Advisors, I was on the staff of the Council on Wage and Price Stability, which was also part of the Office of the President of the United States. Almost my entire time at the Council on Wage and Price Stability was spent as the lead economist on the Presidential Task Force on Reform of Federal Energy Administration Regulation.

Before I went to work for the federal government, I spent four years as a research associate at the Brookings Institution, where I worked on several projects involving economic issues involving natural resources and regulation. Before I went to work for the Brookings Institution, I was a graduate student at the University of Illinois, from which I received a PhD in economics in 1972.

I have prepared two Expert Reports in this matter. The first, filed on December 4, 2000, was preliminary because discovery was incomplete. The second, filed January 17, 2001, supplemented the preliminary report and responded to the preliminary Expert Report of Dr. Gary Dorman. My preliminary Expert Report is attached as Exhibit A to this Declaration. My second Expert Report

is attached as Exhibit B to this Declaration. My resume is Appendix 1 to Exhibit A to this Declaration.

Qwest's Memorandum in Support of its Motion for Summary Judgment ("U S West's Memorandum")[1] cites to *American Professional Testing Service, Inc. v. Harcourt Brace Jovanovich Legal & Professional Publications Inc,* 108 F.3d 1147, 1151 (9th Cir. 1997) for the test for monopolization. According to that test, MetroNet must establish that U S West "(i) possessed monopoly power in the relevant markets; (ii) willfully acquired or maintained its monopoly power through exclusionary conduct; and (iii) caused antitrust injury." The Supreme Court, in *United States v. E.I. du Pont de Nemours & Co.,* 351 U.S. 377, 391 (1956), defined monopoly power as "the power to control market prices or exclude competition." Monopoly power and market power are interchangeable.

U S West claims that MetroNet cannot meet the burden of proving any of these three elements. For the first and the second elements, U S West claims that MetroNet cannot meet its burden because U S West is regulated. Specifically, U S West claims that regulation by the WUTC prevents U S West from controlling price or competition in any market and that the Federal Telecommunications Act of 1996 prevents U S West from excluding competitors. U S West also claims that there has been no antitrust injury.

The regulation of U S West does not prevent U S West from controlling prices or excluding competition. First, regulation by the WUTC does not prevent U S West from

[1] Qwest merged with U S West in 2000. I will refer to the firm as U S West.

controlling most of its prices completely, and the rest of its prices in almost all ways, subject only to a cap. Second, regulation by the WUTC also does not prevent U S West from engaging in exclusionary behavior towards its competitors. Indeed, regulation by the WUTC may increase U S West's incentives to engage in such behavior. Additionally, the Federal Telecommunications Act of 1996 could not automatically result in effective competition in local exchange and exchange access markets and, in fact, did not do so. Third, U S West's behavior has resulted in antitrust injury.

U S West's Memorandum incorrectly states that I will claim U S West has market power solely on the basis of a market share of over 90% of the provision of retail wireline switched local exchange and exchange access services to small businesses throughout the Seattle/Tacoma area. (U S West's Memorandum, p. 17, l. 1-2)[2] I shall refer to this as the wireline retail small business local exchange and exchange access services market While the market share figures come from U S West's own studies, they are not the primary basis for my conclusion that U S West has a high degree of market power.[3] I base my conclusion that U S West has a very high degree of market power in the

[2] U S West's claim on this point is puzzling, as I addressed at length in my preliminary Expert Report the barriers to entry that exist in the relevant market, and stated in my deposition that I was relying on both market behavior and structural conditions in the market for my conclusion that U S West has a high degree of market power. *See* Deposition of Nina W. Cornell, pp. 51-53, Masse Decl., Ex. 41.

[3] U S West notes that I have done no market share studies "of my own" to arrive at a market share figure. This is correct. U S West uniquely has the data to perform the best possible market share studies because of its control over interconnection and telephone numbers. I therefore rely on U S West's internal reports of market share.

relevant market on U S West's behavior, which is not that of a firm facing effective competition, and on high barriers to entry into this market. The persistence of high market share numbers even after the passage of the Federal Telecommunications Act of 1996 lends support to my analysis of barriers to entry. U S West's own behavior and the existence of and persistence of barriers to entry, however, are the primary bases for my conclusion that U S West has a very high degree of market power in the relevant market.

This case involves, among others, the allegation that U S West deliberately structured the pricing of features supplied as part of one of its Centrex services, Centrex Plus, in a manner intended to prevent resale of that service in competition with U S West's basic business service, 1FB (the acronym for a single flat-rated business line). Centrex services are a bundle of three complementary functions: the connection between the customer's premise and the serving central office, referred to in Washington as the NAC (Network Access Channel); the usage of the central office, or NAR (Network Access Register); and features such as call waiting, call forwarding, and the like. Although each of these functions is priced separately, to subscribe to any one of these functions U S West requires that a customer subscribe to all three.[4]

The NAC and the NAR are tariffed, which means that the WUTC can rule (within the limits discussed below) on those rates. Features, however, are not tariffed because, in

[4] U S West requires a subscriber to subscribe to all three functions despite repeated rulings of the WUTC that these three functions be unbundled and available separately. *See, e.g.*, Masse Decl., Ex. 21, p. 127.

1987, the WUTC granted U S West's request that features provided as part of a Centrex service be deregulated.[5] U S West argued that Centrex was a service for large customers and that the service competed with Private Branch Exchanges. That competition, U S West argued, meant that there was no need to regulate the prices charged for features. Because the WUTC granted U S West's petition, the WUTC cannot set the prices U S West charges for features.

WUTC Regulation and U S West's Ability to Control Prices

U S West's argument that regulation by the WUTC means U S West has no control over price reveals an ignorance about the regulatory process in general and the specific regulatory regime in the state of Washington. In fact, U S West has very wide latitude in setting prices for the vast majority of its services, particularly Centrex services in the state of Washington. As a result of the factors that I discuss below in this section of my Declaration, U S West is only slightly constrained in its ability to control price.

First, not all of the services that U S West supplies, including the features provided as part of its various Centrex services, are regulated. For its unregulated services, U S West faces no regulatory constraints on its prices. Second, the realities of both the limited resources available to any regulatory agency and the way the regulatory process operates mean that no regulatory agency has much ability to prevent U S West from totally controlling prices for those services subject to regulation. Third,

[5] Masse Decl., Ex. 7 (U-86-34).

even for services that are at least nominally subject to regulation, the very limited powers that have been given to the WUTC by the state legislature give U S West more latitude in setting prices in Washington than it may have in other states. The result of all these factors is that the regulatory constraints from the WUTC on U S West's ability to set prices are very limited and selective at best.

The WUTC has only limited resources. With those resources, it is supposed to regulate not only U S West, but also at least twenty other telecommunications companies. Moreover, it also regulates gas, electric, steam, water, bus, and garbage companies. This means its limited resources cannot all be focussed on U S West.

The mandate given to the WUTC with respect to the regulation of U S West is to try to ensure that U S West's prices are just and reasonable. In particular, the WUTC is supposed to ensure that the prices U S West charges do not allow it to earn more than a reasonable profit and that no price for a service facing any form of competition is below cost. *See, e.g.,* RCW 80.36.330(3).

To carry out its responsibilities, the WUTC must follow certain legal processes. It must make its ruling based on evidence in a record, and it must articulate its reasons for its decisions. *See, e.g.*, RCW 34.05.461. If any party in a proceeding does not think the WUTC reached the correct decision, it can ask the state courts to review the decision. *See* RCW 34.05.510, et seq. These legal requirements provide the first constraint on the ability of the WUTC to in turn constrain U S West's pricing freedom. In order to show that U S West's prices do not allow it to earn more than a reasonable profit and that no competitive services are priced below cost, the WUTC

must acquire information about U S West's earnings and the costs of providing each of its services. The only place it can acquire this information is from U S West. The WUTC also must rely on U S West to supply information about its projected earnings under different sets of prices. Because U S West controls this information, it begins the regulatory process with a great deal of ability to control the conclusions the Commission can reach. This control over information by U S West forms the first limit on the ability of the WUTC to compel U S West to charge prices other than those U S West wants to charge for all but a very few key services.

Moreover, the power that control over information gives U S West is much greater than might fast be realized because of two facts. The first is that U S West offers a very large number of "services" that are potentially subject to regulation. The second is that U S West has very wide latitude in attributing its costs to specific services.

Over the period when U S West was considered to have had a monopoly over the provision of local exchange service within specific geographic boundaries, U S West established a number of different prices for different classes of customers for what were essentially the same basic functions. In terms of U S West's tariffs, each of these different prices is presented as being a different "service." The tariff for each contains not only prices, but also a description of the service and the terms and conditions under which U S West will provide that service, including what customers are eligible for it. Centrex is a classic example of this. The NAC provided as part of Centrex is a basic access line, no different in function than

a simple business line.[6] The price for the NAC as part of Centrex is different from the price for a simple business line. The NAC is also the same as a voice-grade private line NAC. A voice-grade private line NAC is supplied as a different service with a different tariff.

As a result of this proliferation of services, if not of functions, U S West's current tariff on file with the WUTC fills a notebook approximately four inches thick. No regulatory body has sufficient staff that it could analyze each particular price or term and condition contained in every filed tariff. Even in the context of a general rate case when potentially all of U S West's regulated service rates could be under review, the WUTC can only focus on a few rates, *mainly* those with the highest visibility and political impact. These are the local exchange rates for residential subscribers and, to a lesser extent, small business users: the so-called 1FR and IFB rates. Other parties affected by the rates U S West proposes can offer testimony about perceived problems, but there is no guarantee that the WUTC will accept the validity of that testimony or adopt any suggested changes to the rates U S West has proposed.

In part because of the proliferation of services that are really either different prices for the same basic functions

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[6] In his deposition at pp. 87-89, Mr. Hatzenbuehler, of U S West, claimed that the NACs for large Centrex systems were provisioned differently from 1FB services. Masse Decl., Ex. 42. Mr. Fleming, of U S West, however, confirmed that the provisioning of NACs depends upon the density of NACs going to a neighborhood, not the particular service provided to a given customer in that neighborhood. Fleming Dep., p. 88, l. 23 – p. 89, l. 12; p. 94, ll. 6-25. Masse Decl., Ex. 43.

or different prices for different bundles of a smaller set of basic functions, it is very difficult to uniquely attribute U S West's costs to particular services. In any given geographic area, U S West uses one network to provide a wide array of tariffed services. While some of U S West's costs can be uniquely attributed to particular services, a larger share of its costs cannot. Some of the costs that cannot be uniquely attributed to specific tariffed *services* can be attributed to specific *functions*, but even if such attribution is then assigned to specific services, a large share of U S West's costs remain unattributed. This gives U S West great freedom to insist that one service and not another be required to recover those costs due to demand conditions.

To oppose U S West's view, the WUTC would need evidence in the record challenging U S West's cost attributions, its claims about demand conditions, or both. Again, no regulatory agency could possibly have sufficient resources to engage in such analysis for every service contained in U S West's tariffs. At best, the WUTC could examine only a few services. For all the rest of U S West's regulated services it effectively has complete pricing discretion despite their being nominally regulated.

The third limit on the regulatory constraints facing U S West in Washington is the fact that under Washington law, the WUTC cannot suspend a proposed price decrease that is not accompanied by an offsetting price increase. *See, e.g.*, RCW 80.04.130. In actuality, this means that price decreases cannot be challenged at all by the WUTC. Even if a proposed price decrease is limited to only a few customers, the WUTC has very limited ability to take any action on it. If the WUTC believes the price may be below cost, the only way it could challenge the price decrease

would be to issue a complaint against U S West. Because of the nature of U S West's costs, as discussed above, such a showing would be very hard to make and even harder to explain to a reviewing court. The result is that price decreases are only very rarely challenged, if at all. This means that U S West has virtually unlimited ability to lower prices, with current prices serving merely as a cap. Given that unit costs have been falling for large parts of telecommunications plant and equipment, the price cap created by current prices is not as great a constraint as it might otherwise be.[7]

A fourth limit on the regulatory constraints facing U S West is U S West's ability to offer services on an Individual Case Basis (ICB). In fact, U S West's most feature-rich Centrex service for large users, Centrex Prime, is only offered as an ICB tariff. These prices are confidential and offered only when U S West wants to offer them and only to customers U S West wants to serve with Centex Prime. In essence, these rates face no effective scrutiny whatsoever, as other parties cannot have access to the actual prices being offered.

U S West's freedom from effective regulatory constraint is not simply for price decreases. U S West has the ability to impose charges for "new" services. It also has the

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[7] Modern central office switches are special-purpose computers, and the costs per unit of computing have been falling for some time. The modern technology for the lines that connect one switch to another is fiber optic technology, and the capacity on a single pair of fibers has been increasing over time. Meanwhile, the cost of a pair of fibers has either been steady or falling. Thus, the unit costs of these two categories of plant have been falling. To the extent that loop plant is economically provided over fiber optic plant, as it is in very dense and some other circumstances, the unit cost of that plant has also been falling.

ability to link these to services already being provided. The result can be an effective price increase in the old service without any change in the price elements already in the tariff for the old service. An example of this is the so-called "chip-in" charge that U S West imposed on subscribers to Centrex Plus in 1999. U S West Communications, Inc., Price List, Washington, Exchange and Network Services, Section 9.1.16 B. 20, 1st Rev'd Sheet 33, effective May 15, 1999. *See* Masse Decl., Ex. 44. U S West also has the ability to impose new charges on some customers and not on others.[8] The result can be massive price discrimination.

Because of the factors discussed above, it is false to claim that regulation by the WUTC prevents U S West from having control over price. At most, regulation by the WUTC removes one or two degrees of freedom from U S West for a few of its services, but leaves it with vastly more degrees of freedom than it loses over pricing decisions even for those few services. U S West does not have completely unfettered freedom to set prices for some services, but in no case can the WUTC "set" the price U S West will charge. At most it can set a price ceiling, but not the price should U S West wish to reduce it. For the vast majority of its services, U S West does not face much if any

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[8] For example, when the FCC imposed the Customer Access Line Charge (CALC) to recover the book costs of loop plant previous [sic] allocated to interstate access charges, U S West went to the WUTC and asked to be allowed to apply a CALC offset to Centrex lines to make the amount of these costs effectively imposed on a Centrex system equal to what a comparable user of a PBX would have to pay. The result was to shift book cost recovery responsibility for an equal amount of intrastate book costs away from Centrex to other services. No other service had its prices reduced by a CALC offset, however. *See* Masse Decl., Exs. 1 and 45.

constraint even as a price ceiling. And for some services, including the pricing of features provided as part of Centrex services, U S West faces no pricing constraints at all from the WUTC.

As a consequence, it is incorrect to claim that U S West could not possess market power because regulation prevents it from having control over price. To the extent that the barriers to entry discussed below on pages 27-33 give U S West an ability to control price, one of the two possible indicia of market power, regulation does not and cannot prevent U S West from having almost the same amount of control over price that it would have if it were not regulated.

WUTC Regulation and U S West's
Ability to Exclude Competitors

U S West is also wrong to claim that regulation by the WUTC prevents it from excluding competitors. U S West in fact has a great ability to exclude competitors despite regulation by the WUTC. First, because of the large freedom it enjoys to set its own prices, it can use that power to set prices that exclude competitors in a number of instances. Second, because not all of its services are regulated, U S West can link regulated and unregulated services to effect outcomes that the WUTC has refused to allow for regulated services alone. Third, because the WUTC cannot force U S West to make investments it does not want to make, U S West can exclude or seriously delay competitors by a refusal to cooperate.

Competition to U S West's local exchange and exchange access services can come in at least two ways. First, competition can arise through the resale of U S

West's volume discount services, with the reseller aggregating smaller customers who on their own would not qualify for the volume discount.[9] Second, a firm could enter the market and build its own facilities. A firm that began by reselling U S West services could over time shift some of its customers to its own facilities. In general, resale can allow a firm to enter more rapidly into a given geographic area than it could enter if it had to wait until it had built its own facilities.

U S West's control over pricing is sufficient that it can make resale very difficult if not impossible. Because it has the ability to offer its volume discount services only on an Individual Case Basis, it can refuse to offer a resellable volume discount to any firm that is in the business of resale. Second, because it can lower prices without any effective constraint, it can structure a discount for specific end users that makes it either less profitable or even unprofitable for a firm that has been reselling to continue to do so. U S West can target these discounts by providing them in connection with term commitments or other conditions.

U S West's power over prices is not only direct, as discussed above and in the previous section of this Declaration, but also indirect. U S West sets not only prices, but determines the terms and conditions that it will apply when providing service. These terms and conditions include determining what customers will be eligible for a

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[9] The Federal Telecommunications Act of 1996 requires U S West to offer a wholesale discount off all its services which other firms can then buy to resell. I discuss this version of resale in the next section of my Declaration, which discusses the practical effects of the Federal Telecommunications Act of 1996.

given service. A pertinent example is to limit volume discounts to a given customer location. By requiring that the service be provided to a single "customer," rather than to a single building or city block, for example, U S West has limited the ability of a number of customers to benefit from a volume discount. In fact, however, any unit cost savings that U S West enjoys by virtue of being able to provide a higher volume of services on shared plant occur because of the volume of demand for service in a whole building or even a whole city block.[10] This eligibility requirement directly limits competition by impeding resale of U S West's volume discounted services.

Even where the WUTC has ruled that U S West may not engage in a particular practice with regard to one or more of its regulated services, U S West can achieve the same effect if it can require customers to use an unregulated service as a condition of subscribing to a particular regulated service. This is an example of regulatory avoidance, discussed in ¶ 787b. of Professors Areeda and Hovenkamp's *Antitrust Law*. On pages 280-281, Professors Areeda and Hovenkamp state:

> This treatise often observes that the monopolist at one market level cannot ordinarily make greater monopoly profits simply by acquiring or controlling a second level. The available monopoly profits are determined by consumer behavior at the demand curve, and a monopolist of any essential production or distribution stage could earn all of them. As a result, claims once made that a firm might use vertical integration or tying to

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[10] *See* Deposition of Garrett Fleming, p. 117, l. 6-p. 120, l. 22, Masse Decl., Ex. 43.

monopolize a second market, thereby doubling or at least increasing monopoly profits, are false as a general matter.

But this limitation does not necessarily apply to the price-regulated monopolist, who may be prevented by law from charging its profit-maximizing price in its primary market. Consider this illustration. The cost of delivering local phone service is $10 a month, which is the price set by regulators; however, the profit-maximizing monopoly price is $15 per month. Telephone instruments cost $2 per month. The telephone company then integrates into phone production or acquisition, requiring all its customers to lease one of its own phones at a price of $7 per month.

The company in this case has simply observed that customers must have both the phone service and the telephone instrument and are generally indifferent as to how the price is allocated between the two. The effect of this policy is to transfer the available $5 in monopoly profits away from the regulated phone line, where the regulatory agency forbids the firm from charging its profit-maximizing price, and to the phone instrument, which we presume to be unregulated.

The illustration may seem excessively simplistic. No intelligent regulator would scrutinize line costs while paying no attention to telephone instrument costs when the instrument is "tied in" to the line rental. But the very same problem shows up in numerous more subtle ways. Further, regulatory agencies often lack the resources to verify costs item-by-item or otherwise ensure that firms are not transferring excessive costs from unregulated production into the regulated base. (Footnotes omitted)

IIIA Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* § 787b, at 280-81 (1996).

In fact, just such regulatory avoidance is at work in the instant case. U S West filed its Centrex Plus tariff in 1991 with per-location pricing and with the access line bundled with the features. The WUTC ordered U S West to eliminate the per-location requirements and to unbundle features from the access line portion of the service, citing the harm to resale. *See* Masse Decl., Ex. 1 (Fourth Supplemental Order, Docket UT-911488 (November 18, 1993)). U S West's "compliance" tariff filings did not eliminate per location pricing. They also only broke out a separate price for the features, but did not allow a customer to purchase the line without the features or vice versa. After over a year of procedural wrangling, the WUTC allowed the tariffs to go into effect, noting:

> It is essential that the Commission allow an acceptable proposal to take effect, rather than delay changes to a program that is unacceptable in some of its basic elements. Perfection may be elusive, and may have different meanings to different affected parties. Further delay of the restructuring in time-consuming and resource-intensive pursuit of an elusive and perhaps subjective perfection does not advance the public interest.

See Masse Decl., Ex. 45 (Sixth Supplemental Order, Docket UT-911488 at 2 (WUTC December 2, 1994)).

In U S West's 1995 general rate case, the same issue again arose. The WUTC again found per location pricing to discriminate against resale. *See* Masse Decl., Ex. 21 (Fifteenth Supplemental Order, Docket UT-950200 (April 11, 1996)). Again the Commission ordered U S West to

eliminate location requirements and to unbundle the various elements of Centrex service. U S West initially eliminated per location pricing from both the access line and the features. Later U S West realized that its Centrex features were deregulated, and applied the per-location restriction to the feature prices, restricting the very low prices per line for features to large-volume locations. U S West still has not unbundled the features from the NAC, however, despite the repeated orders from the Commission to do so *see* Declaration of Kenneth Seeley in Support of Motion in Opposition, ¶ 8. Because Centrex subscribers are required to take features, U S West was able to avoid the WUTC's attempt to prevent exclusion of resellers by the tie between its Centrex features price list and its Centrex tariffed NAC and NAR rates.

More broadly, despite regulation, U S West has a great deal of ability to exclude competition beyond its ability to limit or prevent resale competition in the ways discussed above. Telecommunications is not like almost any other good or service in our economy. In those other sectors, firms compete acting independently. Indeed, cooperation or collaboration is strictly monitored for possible anticompetitive possibilities.

In telecommunications, however, competition is not possible without quite a lot of cooperation. This is particularly the case for competition to provide switched services. Consumers have come to assume that subscription to switched services means the ability to reach all other subscribers to switched services, even if some of the calls incur additional charges. I refer to this as ubiquity of reach. Competing providers of local exchange service who supply their own facilities must interconnect to all other

providers of local exchange and interexchange services in order to be able to provide ubiquity of reach.

Because virtually all of the subscribers to switched local exchange service within a given geographic location will initially be customers of the incumbent local exchange carrier, the incumbent has no incentive to grant interconnection. Even when ordered to provide interconnection by a regulatory body, if the incumbent claims it does not have sufficient facilities, interconnection cannot occur until this condition is altered. The WUTC can impose a fine for failure to provide adequate facilities, but unless the fines are significantly larger than the expected stream of profits the firm believes it is protecting by denying interconnection, the fines may not alter the commercial reality of no or insufficient interconnection facilities.

Interconnection, moreover, is not the only form of cooperation required for competition to be possible. Cooperation in provisioning services provided by resellers is necessary for resale to provide all of the competitive effects resale is able to provide. If customers of resellers discover that they will get service that is inferior to the service they would get if they took service directly from U S West, resale will be impeded or even prevented. Such inferior service can include longer delays between the placing of an order for service and the start of receiving the service, more frequent outages, higher blocking rates, and the like.

While the WUTC can order cooperation, it cannot actually compel it. In this sense, the WUTC is like the owner of a horse who believes the horse is thirsty and who can provide water to satisfy the thirst. It can put the water right next to the horse. It cannot, however, compel the horse to drink. The WUTC can issue orders, and impose

sanctions for non-compliance, assuming it can assemble a record to support such an action. It cannot, however, compel U S West to make investments or changes in business practices if U S West believes the gains from failure to comply are greater than the losses from sanctions.

Thus, for all the reasons given above, it is incorrect as a factual matter to claim that regulation by the WUTC prevents U S West from excluding competitors. U S West has a myriad of ways in which it can exclude competitors, and it has very strong incentives to employ them. The WUTC cannot prevent U S West from acting on those incentives. To the extent that the barriers to entry discussed below on pages 27-33 would give U S West the ability to exclude competition absent regulation, regulation removes little if any of its ability to do so despite regulation by the WUTC.

The Federal Telecommunications Act of 1996

U S West also claims it cannot exclude competitors because of the provisions of the Federal Telecommunications Act of 1996. This claim is also false. While a law can compel a monopoly, no law can compel effective competition. Competition does not occur because a law says it is allowed, or even because it is technically feasible. Competition only occurs when:

(1) a number of firms *can* enter a market, that is, the barriers to such entry are relatively low;

(2) a number of firms can reasonably expect to make at least a normal profit after entering the market;

(3) some number, even if less than the number that could enter, actually do enter; and

(4) a large enough subset of actual entrants in fact make normal profits over some period of time thereby enabling them to remain in the market. The higher any barriers to entry are, the higher expected profits must be to make a firm decide actually to enter. Thus, the higher are any remaining barriers to entry after entry is allowed by law, the harder it is for the market to become effectively competitive in an economic sense.

In order for a firm to be able to assess what profit it can expect to make if it enters a market, it must have a basis to estimate what price it can charge for its output and what costs it will incur. While the Federal Telecommunications Act of 1996 imposed a number of duties on incumbent local exchange carriers, it did not specify in sufficient detail how those duties were to be carried out and what the charges to entrants would be to permit a firm to make reasonable judgments about the potential profitability of entry based solely on that Act.

The duties the Federal Telecommunications Act of 1996 imposed on incumbent local exchange companies to facilitate competition for local exchange and exchange access services were of three main kinds. One was a requirement to interconnect. A second was to unbundle their networks and make the unbundled network elements available for other firms to use to provide service. A third requirement was to offer their retail services at an avoided cost discount at wholesale for other firms to resell.

The Federal Telecommunications Act of 1996, however, left it to a combination of the Federal Communications Commission ("FCC") and state regulatory commissions to

determine all the specifics necessary to implement the law. These specifics include the price for interconnection, what network elements to unbundle, the incumbent local exchange carrier's charges for these unbundled network elements, the uses of these unbundled network elements, and the discount off of the incumbent's retail charges for resale purposes. Most of the pricing decisions were to be made by state regulatory bodies, subject to oversight by the FCC. The FCC was supposed to determine what network elements the incumbents would have to provide in an unbundled fashion and how potential entrants could use those unbundled network elements.

Not surprisingly, the issues left to the FCC and the state regulatory agencies are highly contentious. The incumbent local exchange carriers wanted the prices they could charge for interconnection and unbundled network elements to be very high. They also wanted the resale discount to be very small. Potential entrants wanted exactly the opposite. The incumbent local exchange carriers wanted only a very few elements of their networks to be available on an unbundled basis and wanted those that were to be available subject to very stringent restrictions on how they could be used. Potential entrants wanted exactly the opposite. All of these issues, moreover, were to be decided in the same regulatory process outlined above: on the basis of a record where much of the data could only come from the incumbent local exchange carriers, and subject to judicial review if any party did not like the outcome.

Many parties did not like the outcome. The result has been extensive litigation of both the FCC and state regulatory agency decisions. To date, some of the key relevant issues still remain undecided.

The FCC originally passed rules that were supposed to govern the basis for the prices that state commissions, including the WUTC, were allowed to set for unbundled network elements and interconnection. Those rules were appealed, overturned, rewritten, appealed, etc., and are now before the Supreme Court for a second time, five years after enactment of the Federal Telecommunications Act of 1996. In the meantime, the WUTC set "permanent" prices that finally went into effect as of December 2, 2000, but the Supreme Court could overturn the entire cost basis used to arrive at those prices. All the litigation over the implementation of the Federal Telecommunications Act of 1996 means that it may not be reasonably possible even now, and certainly was not reasonably possible before the beginning of this year, to know what the costs would be to enter into any of the local exchange service markets in the state of Washington using either unbundled network elements or the resale provisions of the Federal Telecommunications Act of 1996.[11]

Moreover, another issue before the Supreme Court is what limits the incumbent local exchange carriers can impose on using unbundled network elements in combinations. The issue is whether a potential entrant can order both an unbundled NAC and unbundled local exchange

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[11] Even though prudence should have kept all firms out until the issues were all resolved, some firms tried to enter despite the uncertainty. Wall Street analysts are now predicting a large number of bankruptcies for the so-called CLECs (Competitive Local Exchange Carriers). *See, e.g., Wall Street Analysts Foresee More CLEC Bankruptcies. Capital Woes,* TR Daily, February 21, 2001, Masse Decl., Ex. 46. In it a vice president at Morgan Stanley Dean Witter, Mr. W. Todd Scott, is quoted as saying, "A primary reason the capital markets have closed to CLECs is that investors have an overriding concern that the business model just doesn't work."

switching from U S West, or whether it can order one or the other but not the two connected. Without knowing what use a potential entrant is going to be allowed to make of unbundled network elements, a potential entrant still cannot determine what its costs might be using the unbundled network elements part of the Act and therefore whether there is a reasonable expectation that it could make a normal profit.

Thus, to date, litigation over implementation of the Federal Telecommunications Act of 1996 has created an enormous barrier to use of the rights granted by that Act. Even if that barrier is eventually removed by rulings that would allow potential entrants reasonably to expect to make normal profits, additional barriers to entry into these markets have been created by the fact that U S West filed for and was granted the ability to charge non-recurring charges for subscription to unbundled network elements and resale. *See* Qwest Wholesale Tariffs WN U-42 and WN U-43, Masse Decl., Ex. 47. Non-recurring charges are up-front payments U S West requires from a subscriber at the time that subscriber starts taking a service. For an entrant, these charges represent costs it must incur before the firm has started to earn any revenues from an end user. They are costs, moreover, that the potential entrant may never recover if the end user does not stay with the entrant.

Non-recurring charges form an additional barrier to entry because they are a cost that entrants must incur with no guarantee of recovery but that the incumbent did not incur in that fashion for most of its initiation of services to end users. Whatever costs the incumbent incurred to initiate service to end users became part of its revenue requirement. At least to date, the incumbent is allowed by

law to charge prices that give it a reasonable chance to recover the revenue requirement. If the incumbent did not recover them from the particular end user who caused them, it was able to and did recover them from the general body of rate payers.

Entrants do not have this option. For entrants, the non-recurring charges assessed by U S West are a classic example of a sunk cost.[12] As such, they form a barrier to entry both because the firm incurring them cannot recover that cost if it should be commercially unsuccessful in the market and because the incumbent firm did not and does not bear the same cost. As a result, a firm considering entering the market using any of the provisions of the Federal Telecommunications Act of 1996 would need to have a reasonable expectation of higher than normal profits to cover the risk posed by the existence of sunk costs.

For the reasons discussed above, it is wrong to claim that U S West has no power to exclude competition because of the provisions of the Federal Telecommunications Act of 1996. To the extent, therefore, that the barriers to entry discussed below in pages 27-33 give U S West the ability to exclude competition, one of the two indicia of market power, the Federal Telecommunications Act of 1996 so far has done nothing to deny U S West any of that power. It may be that over time the various issues will be resolved in a manner that does deny U S West more of

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[12] A sunk cost is a cost that, once incurred, cannot be recovered in full if the firm is commercially unsuccessful and has to exit the market. Some costs can be recovered from the sale of assets, but where there is no asset, or where the full cost to acquire the asset cannot be recovered, the unrecoverable amount is considered a sunk cost.

that power, but that time has not yet arrived. Even once the implementation of the Federal Telecommunications Act of 1996 is settled, however, the example of the imposition of non-recurring charges shows that U S West retains the power to impose barriers to entry into its markets.

Antitrust Injury

U S West's Memorandum also claims that there has been no antitrust injury from U S West's behavior. On page 19 of U S West's Memorandum, U S West cites to *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d at 1433, ("*Rebel Oil*"), for the proposition that antitrust injury requires harm to consumer welfare, and that harm to consumer welfare occurs "only when conduct 'harms both allocative efficiency *and* raises the prices of goods above competitive levels or diminishes their quality.'" In economic terms, "allocative efficiency" occurs when a society's resources are used to produce the goods and services most valued by consumers in that society. For example, if a ton of steel is going to be used to produce refrigerators but consumers would pay more if that ton of steel were diverted into making freezers, allocative efficiency is increased if the steel gets used for freezers instead of refrigerators.

Allocative efficiency is one outcome of effectively competitive markets. In such markets, consumers pay prices that are very close to or at the efficient costs of providing goods and services. Consumers have only limited incomes, and so they select the goods and services they most want. Through the choices consumers make, producers are able to earn the revenues from which they

in turn bid for additional resources to make additional goods and services. If consumers do not buy a producer's output, that producer can no longer continue to bid for additional resources.

In terms of the standard set in *Rebel Oil.* U S West's behavior has resulted in antitrust injury in three areas. U S West's per-location pricing of Centrex Plus features, by curbing resale, has made it more difficult for effective competition to determine where consumers would prefer resources get used, a harm to "allocative efficiency" in economic terms. It has done this is [sic] two ways. The first is that, by curbing resale, it has reduced the ability for the competition between Centrex and Private Branch Exchanges provided to medium sized and large businesses to operate efficiently. Secondly, by curbing resale, U S West has slowed the development of effective competition in the markets for providing local exchange and exchange access services to small business users. These are the first two areas of antitrust injury from U S West's behavior. The third is that U S West's behavior has raised the cost of features to small business users far above the competitive level, and has kept the price of local exchange and exchange access services to those same users above competitive levels.

The effect of U S West's per-location pricing of features sold as part of its Centrex Plus service was to reduce or eliminate resale. Resale brings at least two major benefits to consumers in telecommunications markets. First, if resale cannot be circumscribed, it forces the firm whose services are being resold to limit volume discounts to levels that are cost-based. Without resale, the firm might be able to offer volume discounts that were greater than the costs saved and recover the lost revenues from

smaller users. Second, again if it cannot be circumscribed, resale allows entry to occur more rapidly into a number of telecommunications markets than if entrants have to provide service only on their own facilities.

The reason that resale forces volume discounts to be cost-based is that resale, if unable to be curbed, takes the volume discounts offered the favored customers and makes them available to many more customers. If the volume discounts are cost-based, the firm offering them is unaffected by this outcome. It saves the costs it would have incurred to retail its services to the smaller users who are now served by the reseller, but it nets the same revenue from those customers. Therefore, it should be indifferent to resale when volume discounts are cost-based.[13]

If, however, the volume discounts are greater than warranted by costs saved by serving in volume, resale of those volume discounts will result in a loss of net revenues to the underlying firm. In this case it will have to choose between lowering its prices to the smaller volume users so as to reduce the loss of such customers to resale, or reducing the volume discount offered to larger users. When, as was the case for Centrex, the revenues from users of the volume discount service were a relatively small percentage of the firm's total revenues, it is more likely to reduce the

[13] This analysis ignores the concern that in a dynamic industry, where there is expansion in the total number of services that will be offered over time, loss of direct contact with a customer may make it more difficult to expand the number of services sold to that customer. In such a case, the underlying firm may still not be indifferent to competition from a reseller, despite the lack of any impact on current net revenues from resale. Attempts to monopolize customer control are the same, however, as attempts to monopolize the provision of service to the customer.

volume discount. Such effects do not occur instantly but will occur over time as the impact of the effect of resale on net revenues from small users becomes more apparent. This benefits consumers by ensuring that the competition for the larger users is not distorted by below-cost volume discounts.

The main reason why U S West wants to offer volume discounts is that competition is greatest for the medium to largest volume telecommunications users. This is not surprising because the larger users offer entrants larger gains from marketing costs, as well as helping to establish a base of usage. In this case, the competition was from large Private Branch Exchanges (PBXs).

PBXs are part of an end user's terminal equipment and they perform several functions. First, they allow all the users connected to a given PBX to economize on the number of telephone lines needed between the PBX and the central office, because the users can share lines.[14] Second, they allow the users connected to a given PBX to communicate with each other without going through the central office. Third, they offer a number of features such as call transfer among the users connected to a given PBX, call hold, and a form of conference calling. Over time, the number of features PBXs have offered has grown, and now include a number of communications management functions such as least-cost routing, call accounting, and the like.

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[14] Except for a few businesses, not all employees of a firm will be on the telephone at the same time. There are standard calculations that determine how many lines a given number of users need to ensure a very low probability that any given user would not have a line available when needed. The number of stations that can share a single line increases as the total number of stations increases.

U S West can offer most of the benefits of a PBX through use of its central office as the source of the features. This is the service called Centrex. There are two volume discounts that come with Centrex service. The first is a discount on the price per line of features supplied as part of a Centrex system. The second is a discount on the price per line for the lines between the customer's premise and the central office.

The one benefit Centrex cannot offer is economizing on the number of lines needed between the customer premise and the central office. Centrex systems require each user within the given Centrex system to have a separate line to the central office. Centrex customers, however, may not need as much terminal equipment as do PBX users.

If there were effective competition for all of these elements – lines between customers and the U S West central office, PBXs, and the various kinds of terminal equipment needed to use Centrex – the market would determine the circumstances, if any, under which it would be more efficient for the various features provided by both offerings to be provided by Centrex rather than a PBX. It is not the case, however, that at any time between the time all of the Centrex tariffs and prices were established and today that there has been effective competition for lines between customer premises and U S West central offices. Under these conditions, unlimited resale of Centrex services is one means of ensuring that the prices U S West offers for Centrex in its attempts to compete with PBXs do not discriminate between Centrex users and other users of lines.

The volume discount on lines subscribed to as part of a Centrex system reduces the amount of the savings available to a PBX user from economizing on the number of these lines. If the volume discount is not cost-based, the reduction in the amount of savings on lines may lead some customers to choose Centrex when a PBX would actually result in a higher value of use from society's scarce resources. Because the investments used to provide lines between customer premises and central offices are a significant portion of the total cost of a telephone network, distorting the ability of the market to efficiently choose how much of this plant is needed indeed harms consumers. It also reduces the ability of PBXs to compete with Centrex. This is the first area of antitrust injury caused by the behavior at issue of U S West. It is a distortion of the market to provide features to medium and large sized businesses, or in the language of *Rebel Oil,* a harm to allocative efficiency.

The second area of antitrust injury from U S West's behavior has been in the various wireline local exchange and exchange access markets. Resale offers a faster method of entry for a firm that has decided to enter in competition with U S West Resale can be used to gain customers before an entrant has had the time or ability to build its own facilities. Resale also can be used to extend an entrant's network beyond the reach of its existing facilities. Thus, resale enhances dynamic efficiency by allowing a former monopoly market to move more rapidly towards effective competition.

For all of the reasons given above in the discussion of the Federal Telecommunications Act of 1996, resale of Centrex has been the most viable form of entry up to now. By hindering the most viable form of resale effectively

available prior to final resolution of the various issues still outstanding under the Federal Telecommunications Act of 1996, U S West has prevented that form of dynamic allocative efficiency. This is another example of the harm to consumer welfare from the actions of U S West.

The third area of antitrust damage is in the markets for small business users. U S West's per-location pricing of features as part of Centrex Plus has forced small users to pay higher prices for features than the competitive price. They also have had to pay higher prices for local exchange and exchange access service than the competitive price.

U S West's per location pricing scheme set the price per line for features to locations with less than 20 lines at a price at least 5.7 times higher than the price per line for features to a location of fifty or more lines. According to the cost studies U S West has performed for submission to the WUTC, the cost of providing features is the same per line whether there is one line per location or many. When U S West supplies features to an end user, it does so through the central office switch and the cost to provide them is a programming cost to tell the switch to make the features available to a given line and the cost of some switch capacity. The programming has to be done for each line. At most, there may be an economy in the one-time establishment costs of having to perform this for many lines at the same time. There is no economy of volume in the recurring costs, which are supposed to be the basis for the monthly rates at issue. *See* Plaintiff's Report on Telecommunications Issues, ¶¶ 55-59; *see also* Deposition of Frank Hatzenbuehler, retired from U S West, page 16, line 6, to page 17, line 2, Masse Decl., Ex. 42.

Given the absence of any recurring per-line cost savings from providing features to large volumes of lines per location as compared to a small volume of lines per location, there is no cost basis for the huge differential in the cost per line for features in the two cases. In an effectively competitive market, the price for features would be close to or at cost. Assuming that the price per line for features to locations with fifty or more lines is the price closest to the one that would be charged in an effectively competitive market, the price being charged smaller users is clearly far above that price.[15]

Restricting or eliminating resale of Centrex also has forced small business customers to have paid prices above the competitive level for local exchange and exchange access services. Witnesses for U S West claim that small business services were providing a "cross subsidy" for residential users. *See, e.g.,* Deposition of Delores Legg of U S West, page 40, lines 20-25, Masse Decl., Ex 25.[16] A service that is providing a cross subsidy has prices for that service that, by definition, are above cost. Such a cross subsidy could not continue if there were effective competition for providing local exchange and exchange access service to small business users. Thus, the restriction on resale of U S West's Centrex services served also to keep

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[15] If the volume discounts for features have resulted in prices to large users that are below the competitive level, the antitrust damage in the market for supplying features to large users is increased.

[16] Based on my experience in regulatory proceedings involving U S West, where I saw confidential cost information, U S West could not prove residential local exchange service was or is subsidized when the proper economic test for cross subsidization is used.

prices for local exchange and exchange access services above the competitive level.[17]

The Source of U S West's Market Power

U S West has a very high degree of market power because of inherent structural conditions in the markets for wholesale provision of services to suppliers in the relevant retail market that create enormous barriers to entry. As I noted above, the relevant market is the provision of retail wireline switched local exchange and exchange access services to small businesses throughout the Seattle/Tacoma area Resellers act as suppliers only in a retail market. They must get services to resell from providers with facilities. When a facilities-based provider is providing services for resale, it is acting as a wholesaler.

There are at least three structural conditions in the wholesale switched local exchange and exchange access services markets that, particularly in combination, have given and will continue for some time to give U S West a very high degree of market power in wholesale wireline switched small business local exchange and exchange access services markets. Because of its market power in the wholesale markets, U S West also has a very high degree of market power in the relevant retail markets. These three conditions, or conditions similar to them, do not exist in almost any other markets and make all switched local exchange service markets different from almost all other markets.

[17] I outlined most of these forms of antitrust injury in paragraph 18 of Exhibit B to this Declaration.

The first condition is that wireline switched local exchange services markets require that each customer premise be connected to the location from which wireline local exchange service is actually provided by an unbroken physical connection. The second condition is that wireline switched local exchange services markets require direct cooperation among competitors if competition is to be possible at all. The third condition is the past history of treating switched local exchange services markets as franchised monopolies. Because of this past history, U S West has physical connections to every location in its past serving territories, and these connections now create a large barrier to entry by another firm. Moreover, again because of the past history of treating switched local exchange services as a franchised monopoly, the need for cooperation is one-way, meaning that entrants need such cooperation from U S West far more than U S West needs it from entrants. This gives U S West enormous market power over new entrants to the extent that legal forces do not or cannot constrain U S West.

1. The Role of the Loop Network

The first difference between most markets and wireline switched local exchange services markets is that wireline switched local exchange services require a physical connection, called a loop or an access line, that runs unbroken between the location of the customer and the location from which the local exchange carrier supplies the switched local exchange services. This latter location is the location where the wireline local exchange carrier has a switch to which the line serving the customer is connected. The switch connects either directly or by connections to

other switches the line of the customer to the lines of all other subscribers to switched telecommunications services.

The customer does not own the loop that serves it. Instead, the company providing service to the customer provides the loop when that customer subscribes to switched local exchange service. This requirement can be compared to the situation facing a retail provider of office paper. The customers of such a retailer must have an unbroken path between their premises and the location of the retail store at which they intend to buy paper, but that path is the public (and private) road system provided by neither the retail store (except perhaps for the parking lot at the store) or the customer directly (except perhaps for the customer's driveway and any private and leading to the public road system). Moreover, the public road system is used to connect customer premises with a very large number of different retailers, not just the retailer of paper. The loop serving a switched local exchange service subscriber, however, leads only to the switch from which that subscriber takes switched local exchange services.

2. The Need for Cooperation among Competitors

The second difference between switched local exchange markets and almost all other markets is that firms that compete to provide switched local exchange services cannot do so independently of all other firms in the same market. This cooperation is needed to provide the customers of all suppliers ubiquity of reach, as discussed above on pages 15-16. As also noted above on pages 15-16, the need for cooperation applies not only between facilities-based providers, but also between facilities-based providers and resellers. Because of how resale of switched local exchange

telecommunications services is performed, a reseller needs as much cooperation from the personnel within the wholesale firm who install services, make repairs, and the like as does the wholesale firm's own sales force.

A reseller of switched local exchange telecommunications services does not collect those services at its own premises and then offer them to the public. Instead, such a reseller goes out and persuades customers to take service from it. Once the reseller has a client, it contacts the wholesale carrier and advises it to install the service to be resold at the premise of the end user customer. The reseller may be the initial party that is billed for the service, but that reseller is not the party that physically installs and maintains the service. Those functions are performed by the wholesale carrier whose services are being resold.

Again, this is in contrast to the situation with the retail sales of paper. A competing retailer can go to a paper wholesaler and get the paper it needs from that firm even if the wholesale firm also sells paper at retail. Once the competing retailer has acquired the paper, the wholesale firm has nothing more to do with the sale of that paper. While such a firm does need to be aware of the prices all other firms charge for each kind of paper in order to stay in line with market prices, it otherwise does not need to interact with its competitors. The only continuing interaction between the wholesaler and the competing retailer is the indirect information flow about the retail price for paper and the direct contact involved when the competing retailer needs more paper.

3. The Role of Past Wireline Switched Local Exchange Service Franchises

A third difference between wireline switched local exchange services markets and almost all other markets is that, in the past, all wireline switched local exchange services markets were treated as franchised monopolies. This means that in every such market there is one firm, the former monopolist or the "incumbent," that previously supplied all of the services to customers within that geographic region. This position of incumbency gives that firm two advantages that it would not have in wireline switched local exchange markets if all firms were entering the market at the same time. These two advantages are ones, moreover, that differ at least in degree from advantages that incumbent firms have in most other markets. The first is that the facilities of the incumbent create very large barriers to entry, barriers to entry that are larger than those that may exist in most other markets. The second is that the position of incumbency turns the need for cooperation into an enormous source of market power for the incumbent.

a. existing loop plant as a barrier to entry

The incumbent local exchange carrier has ubiquitous facilities reaching geographically every part of the market where subscribers have had premises. This incumbent, moreover, has had perhaps as long as one hundred years to build its network of loops. This embedded loop plant of the incumbent creates a massive barrier to entry to other firms that might want to build facilities only for telecommunications except in limited geographic areas where subscriber numbers or telecommunications service volumes are very high.

An entrant that wants to build wireline facilities that will be used only to provide local exchange and exchange access services will only be able to recover its costs and make a profit (be "commercially successful") if it can garner a sufficient quantity of telecommunications subscribers and/or traffic. To do this, the entrant must first build at least some facilities and then successfully market to end users to overcome customer inertia and habit. The cost of building the facilities will be almost entirely a sunk cost, meaning that it will not be able to be recovered in full if the entrant is unsuccessful in a commercial sense. Moreover, the cost of marketing will also be a sunk cost. The fact that almost all of the costs of entry once incurred will be sunk is itself a barrier to entry.

An entrant that builds facilities in the limited geographic areas that have very high levels of telecommunications traffic ("dense areas") has a much higher chance of being commercially successful than does an entrant who builds in less dense areas. In more dense areas not only is there more potential business, but the cost of the facilities on a per unit basis will be lower than in less dense areas. The unit cost of marketing to overcome inertia may also be lower in more dense areas than in less dense ones. The result of this is that as the telecommunications density of an area falls, the existence of the facilities of the incumbent becomes an ever larger barrier to entry by a competing provider of facilities.

This contrasts with the situation that would exist if there were no incumbent. Under this condition, several firms might construct facilities in a number of areas, all hoping to add sufficient customers to make the construction commercially successful. The costs of marketing, once incurred, would be sunk, which would still create barriers

to entry. At least some of the costs of construction, however, would most likely not be sunk, as an entrant that was not successful would likely find a buyer for those facilities, even if the price were less than the full cost of construction. Thus, in a switched local exchange services market with no incumbent, the height of the barriers to entry created by the fact that some costs, once incurred, would be sunk would be less than the height of the barriers to entry created by the existence of the facilities of the incumbent firm.[18]

b. the need for cooperation as a source of market power for the incumbent

As noted earlier, competing providers of switched local exchange services must cooperate with each other for competition to be possible. If all firms providing facilities for switched local exchange service had begun offering those services simultaneously and if it became clear that

[18] The height of the barriers to entry into wireline small business switched local exchange service given the facilities of the incumbent is greater than is experienced in other markets with an incumbent firm. To some extent, the existence of an incumbent firm with a long history in a market creates some barrier to entry if only because consumer inertia forces an entrant to spend more per unit of output on marketing than the incumbent needs to spend. In many other markets that serve end users, however, the barriers to entry caused by the existence of an incumbent firm are often offset by the ability of entrants to offer somewhat diversified products to cater to somewhat diversified consumer taste. In wireline switched local exchange service, however, most diversity of customer taste is served by different features provided by the switch rather than by different kinds of loop plant. Thus, the height of the barriers to entry into providing alternative wireline facilities to all customer premises in a local calling area is greater than is the height of barriers to entry created by incumbency in most other markets.

no one firm could expand its market share at the expense of another firm by refusing to cooperate, all firms would find it in their interests to cooperate. Even if no firms cooperated at the outset, two such firms would soon realize that by cooperating, they could offer their customers expanded calling scope in teams of the number of other parties the customers of those two firms could reach. Over time, all firms would find it in their interests to follow suit.

Because one of the firms in the switched local exchange markets, the incumbent (U S West), previously was treated as though it had a franchised monopoly for the whole market, however, the incumbent has no incentive to cooperate. If it does not interconnect with a potential entrant, that firm cannot enter the market. Even if the incumbent does interconnect, or is forced to interconnect, it can use the form of or price for interconnection to prevent entry altogether or to limit the extent of such entry by a competing provider of facilities. In short, the incumbent has an incentive *not* to interconnect with potential entrants, but potential entrants cannot enter without interconnection. This gives an enormous degree of market power to the incumbent switched local exchange provider, namely U S West.

The cumulative effect of the barrier to entry posed by the incumbent's network of loops and the market power conferred on the incumbent by the need for interconnection by a potential entrant that wants to build its own loops means that fewer firms have entered switched local exchange service markets with their own facilities and the geographic reach of those facilities is less than otherwise would be the case. Moreover, future entry will be relatively slow. This means that small business end users will not

have substitutes for wireline switched local exchange services for some time to come.

U S West, as the incumbent firm, still has a very large market share and holds a monopoly over facilities in large geographic portions of the market. This monopoly over facilities will not disappear in the near future. As a result, any firm that wants to compete only at the retail level has no choice but to turn to U S West for services to resell. This gives U S West an enormous degree of market power in the retail wireline switched small business local exchange market. Moreover, U S West's market power in this market will continue to exist for a considerable period to come.

All of the sources of market power described above are unchangeable by regulation. Regulators cannot make loops terminate simultaneously in several central office switches because the technology does not permit that. As discussed above on pages 15-16, regulators cannot force US West to cooperate if it finds it financially more attractive not to cooperate. Finally, regulators cannot suddenly shrink the size of US West's network so as to open part of the geographic market to other firms. Thus, US West has and will continue for some time to come to have market power in the relevant market irrespective of regulation.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Signed this 5th day of March 2001 in Meeteetse, Wyoming.

/s/ Nina W. Cornell
Nina W. Cornell

Honorable John C. Coughenour

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

METRONET SERVICES CORPORATION, and METRONET TELEMANAGEMENT CORPORATION, Plaintiffs, v. US WEST COMMUNICATIONS, INC., Defendant.	Civil No. C00-0013C EXPERT REPORT OF DR. NINA W. CORNELL

I. Introduction and Conclusions

MetroNet has accused Qwest (formerly US West) of seeking to maintain a monopoly over the provision of retail local exchange and exchange access services to small business customers in the Seattle/Tacoma area. MetroNet claims Qwest sought to maintain that monopoly by discriminating in the prices Qwest charges some subscribers for Centrex-type services in order to prevent resale of those services to small business customers. Discrimination in an economic sense exists whenever differences in the price for a good or service or in the terms and conditions under which that good or service will be supplied vary between two customers and those differences do not efficiently reflect differences in the cost of serving the two customers.

In the case at hand, Qwest has imposed a per line price differential on the features supplied as part of a

Centrex service to different customers based on the number of Centrex lines supplied to a given location. If there are more than 50 lines at a location, the price Qwest charges per line for features is much lower than the price charged per line for features if fewer than 20 lines serve a location. Qwest's cost studies, however, do not show that the cost per line of providing features as part of a Centrex service varies depending upon the location of the customer or the number of lines going to that location. Because the price difference does not reflect an efficient difference in the cost of providing the service, this price difference is price discrimination in an economic sense.

Based on the evidence that I have seen to date, I have reached three main conclusions in this case. First, the relevant market for this case is the provision of retail wireline switched local exchange and exchange access services to small businesses throughout the Seattle/Tacoma area. I shall refer to this as the wireline retail small business local exchange and exchange access services market. Second, Qwest had and continues to have a very high degree of market power in the relevant market. Third, Qwest has used and is using that market power to try to maintain a monopoly over the retail wireline small business local exchange market by engaging in anticompetitive price discrimination.

These conclusions are preliminary. I understand that Qwest has asked the Washington Utilities and Transportation Commission (WUTC) to classify its business services in the Seattle/Tacoma area as competitive. I also understand that Qwest bears the burden of proof in that regard. Therefore, I would expect it to have filed data with the WUTC in support of its petition. I had not seen that data at the time that I had to prepare this statement.

The preliminary conclusions I have reached are based on my education in economics, my long experience examining economic issues in the telecommunications industry, and examination of a number of internal Qwest documents. My experience in examining economic issues in the telecommunications industry includes sensing as the Chief of the Office of Plans and Policy of the Federal Communications Commission for approximately three years, discussions with many employees of different kinds of telecommunications providers, serving as a witness in a large number of state regulatory proceedings, and reading testimony and documents as part of preparing for those state regulatory proceedings. One of my assignments was as the expert for the staff of the WUTC in Docket Nos. UT-911488, et al., a case examining proposed tariff changes by US West for its complex business line, private line, and Centrex Plus rates. My education and experience are detailed in my resume, which is attached as Appendix I to this report. The documents I have reviewed specifically for this case are listed in Appendix II to this report. I charge $360 per hour for my work on this case.

The remainder of this statement lays out my application of my economic training and experience to the facts of this case as I understand them.

II. The Relevant Market

This lawsuit is ultimately about a claim that Qwest has market power and has used that market power to try to maintain a monopoly over the provision of switched local exchange and exchange access services to small business customers in the Seattle/Tacoma area. Small business users are business customers with only a few

lines and with insufficient traffic to justify using higher capacity facilities such as DS1/T1 or DS3 lines. DS1/T1 and DS3 lines use facilities that are different from ordinary business telephone wires, as is further explained in the statement of Mr. Kenneth Wilson. Small business users largely subscribe to what Qwest refers to as 1FB service, which stands for one Flat Business line. A Flat Business line is an ordinary telephone line with unlimited. or "flat-rated," local calling supplied to a business user.

The customers in the small business category are not as static as customers in the residential category. Moreover, the conditions affecting the market have been changing over the last decade. A business may open with only one or two lines and have little traffic. Over time, however, that business may grow to a size to justify changing from 1FB lines to a T1 line. Another business with the same number of employees starting at the same time could have enough data traffic to justify starting with a T1 almost from the outset.

During the last decade, moreover, with entry into the provision of T1 service by a number of firms, prices for T1 service have fallen, changing the economic trade-off point between 1FB and T1 service. With the increased competition to prov de T1 service, entrants have provided more information in the marketplace on T1 service, also changing the trade-off point between the two services. Despite this, however, there are still a large number of businesses at any given point in time for which T1 service is not economic and who must therefore rely on 1FB service or its substitutes.

In order to analyze the claim that Qwest has market power it is necessary to define a relevant market. My

analysis in this section of my report lays out why I believe the relevant market that should be used to determine whether Qwest has market power is the market for the provision of switched wireline local exchange and exchange access services to small business customers throughout the Seattle/Tacoma local calling areas.

A. General Principles for Determining a Relevant Market for Antitrust Analysis

A relevant market for purposes of analyzing whether a firm has engaged in anticompetitive conduct is determined by looking at possible substitutes for a given good or service on both the demand and supply sides. If a good or service is a substitute on either the demand or the supply side for the good or service under study – A – then it is in the same market as A. If there are no substitutes on either the demand or the supply side for A, then A is in a separate market by itself.

A substitute on the demand side for good or service A is a good or service that a fairly large number of consumers would use as a substitute for A if the price for A were to rise, say by 5% or more, with that price increase not caused by an increase in cost and with no cost increase for the substitute good or service. A substitute for A on the supply side is a substitute set of production facilities that could and would be converted within a finite period of time, usually within a year, to the production of A or a substitute for A if the price for A were to rise by the same 5% or more, again with the price increase not caused by a cost increase.

A relevant market is defined by substitutes because the existence of substitutes can constrain the behavior of

the firm or firms producing A to behavior consistent with effective competition even if there are insufficient firms producing A itself to achieve that result. If substitutes on either the demand or the supply side are already in the market, the firm or firms producing A cannot raise price above cost without losing total sales quite rapidly. This makes any price increase unprofitable, and would force the firms to lower prices back to cost. If this were to occur, the market would be effectively competitive.

In the absence of sufficient constraints, however, the firm or firms producing A may have market power. Whether they actually do have market power depends upon how quickly new firms could enter the market in response to a price increase not caused by an increase in costs. If the firm or firms producing A have no substitutes actually in the market, they might be able to raise price above cost without initially losing sufficient sales to make the price increase unprofitable. If, however, substitutes on either the demand or supply side can move rapidly into the market – say within a year – the firm or firms producing A will have to lower prices in response. In this case, whatever market power the firms producing A have currently is transitory and the market would be considered effectively competitive after a short lag.

Thus, the ultimate question is whether the firm or firms producing A behave now, or will behave within about a year, the way firms in effectively competitive markets behave, namely they are unable to raise prices above cost. If the firm or firms producing A initially behave in a manner unlike the behavior of firms facing effective competition, the ease of entry by firms that would offer substitutes on either the demand or the supply side offers

insights about the ability of the original firms to continue to do so for a prolonged period.

For an alternative good or service to provide a substitute for A on the demand side in an economic sense, the alternative good or service must be priced, on a quality-adjusted basis, at or below the price of A. That means that if the alternative good or service is of the same quality as A, the price for the alternative cannot be significantly higher than the price of A. If the standard is whether the firm or firms producing A can raise the price above cost by 5% and profitably maintain that price increase for a year, a potential substitute of equal quality will not constrain the firm to rescind the price increase if the price of the potential substitute is more than 5% higher than the original price for A. If the quality is less, the price must be sufficiently lower to compensate for the reduction in quality. If the quality is greater, however, the good or service may not be a substitute because consumers may not want to pay for the additional quality. In this latter case, even if the alternative good or service can technically perform some or all of the same functions as A, it is not able to constrain the pricing behavior of the firm or firms that produce A.

For alternative production facilities to constitute a substitute on the supply side, they must be able to produce A at a cost equal to or less than the current price of A. If the alternative production facilities can produce a good or service that offers all of the same functions as A but at a cost and price that is significantly higher than the price of A, the alternative production facilities are not substitutes on the supply side.

A relevant market has both a product dimension and a geographic dimension. All of the products and alternative production facilities that can be used to substitute for A in the location where it is supplied constitute the relevant market. Thus, if an alternative product or set of production facilities that could make a substitute for A exists but in a location that consumers currently using A cannot effectively use, that alternative product or set of production facilities is not in the relevant geographic market.

B. Application of the General Principles for Market Definition

The services supplied by both MetroNet and Qwest during the relevant period were retail wireline switched local exchange and exchange access services in the Seattle/Tacoma area.

1. Demand-Side Substitutes

Switched local exchange and exchange access services have no substitutes on the demand side. These services are used for two-way communications mostly in real time with other persons in the same local calling area (switched local exchange services) or to connect to facilities that in turn permit two-way communications mostly in real time with persons in other local calling areas (switched exchange access services). A local calling area is the geographic region within which calls are priced according to local exchange service tariffs rather than interexchange service tariffs. For customers who have flat rate local calling, this means there is no separate charge for each local call.

While wireless options can also provide two-way communications mostly in real time, they are higher priced than wireline switched local exchange and exchange access services. They also have significant quality differences that matter particularly for business users. The sound quality is not always as good as the sound quality of wireline calls. Wireless calls also can get dropped in the middle of sentences. Until very recently, they were not suitable for data transmission, and even now the speed of data transmission possible over most wireless facilities is less than over wireline facilities.

Experience to date shows that consumers do not substitute wireless services for wireline local exchange services. Instead, wireless services were used in addition to wireline services. Other than wireless services, there are no technically equivalent possible substitutes. Mail services are slower, not necessarily two-way, and not real-time. Local travel is much more costly, in part because of the time involved. Thus, the relevant product market consists solely of wireline switched local exchange and exchange access services.

2. Supply-Side Substitutes

Wireline switched local exchange and exchange access services require the use of network facilities that connect each person that wants switched local exchange or exchange access services with every other person in the same local calling area or with providers of interexchange services. These network facilities consist of unbroken wires connecting the customer premise to a switch (usually called "loops"), switches, and trunks connecting switches to each other or to the facilities of interexchange carriers. As noted

above, wireless technology is both priced sufficiently higher than wireline services and fails to offer comparable quality of service. These factors mean that wireless service is not a substitute on the demand side. Because the firms supplying wireless service already charge prices sufficiently higher than the price for wireline service, those firms have revealed that they do not regard wireless service as a substitute on the supply side either.

Currently, only telephone wires can provide wireline switched local exchange and exchange access services to *all* customers within a local calling area. Fiber optic rings, supplied particularly by newer competitive local exchange carriers ("CLECS"), are found in only a few cities. Even in cities where they do exist they are very limited in their geographic coverage, usually confined to the central business district or districts of the metropolitan areas in which they exist at all. Cable television facilities are beginning to be modified to carry telephone signals as well, but they do not serve most business areas within a local calling area. Although research is underway into using electric wires to also carry telephone signals, this research has not yet resulted in commercial applications in the United States nor is there any indication that such applications will occur within the next year or two. In any event, neither fiber optic rings, cable television facilities, nor electric wires provided alternative telephone service throughout the Seattle/Tacoma area during the relevant time period.

The result of the limitations on the wires available to provide switched wireline telecommunications services to all customers within a local calling area is that most small business switched local exchange service users have no means of acquiring switched local exchange service except

through the use of the loops of the switched local exchange provider that has long been the sole switched local exchange telecommunications service provider in that local calling area (the "incumbent"). Some cable television providers are beginning to compete to provide switched local exchange and exchange access services to residential customers using the cable previously reserved only for video signals. As explained in the statement of Mr. Wilson, however, these facilities do not currently serve and may never serve small business users, in part because small business users do not want and thus will not pay for the video signals.

CLECs are beginning to compete for the business of large business customers in very selected locations. CLECs, however, mainly provide high capacity services, particularly DS1/T1 or DS3 services. As noted above, these services use different facilities from those used for ordinary business lines. Small business customers in large metropolitan areas, however, do not use these services and are not concentrated in only one or a very few specific locations within the larger metropolitan area. Instead, they exist in various locations throughout the local calling area.

Qwest uses a different internal division to market to small business customers than it uses to market to either residential customers or to large business customers. Because these customers have different needs from large business customers, and because the facilities used to serve them are different from the facilities used to serve large business customers, I believe they constitute a separate market from large business customers.

Small business customers are also in a different market from residential customers. Small business customers pay prices significantly higher than the prices residential customers pay. Regulations prevent small business users from subscribing to residential telephone service. Because the prices at which they are served are so different from the prices charged residential customers and because small business customers cannot substitute residential service for business service, the provision of wireline switched local exchange service to small business customers constitutes a separate market from the provision of wireline switched local exchange service to residential customers.

3. The Geographic Dimension of the Relevant Market

Because network facilities for providing switched local exchange and exchange access services are geographically specific, only network facilities situated within or at most directly adjacent to the specific local calling areas in question can provide wireline switched local exchange or exchange access services. Thus, the geographic dimension of the market or markets relevant for determining whether Qwest had market power are the local calling areas in which both Qwest and MetroNet operated during the relevant period, namely the local calling areas in the Seattle/Tacoma area. This means that geographically the relevant market is either all one market consisting of the Seattle/Tacoma area or, in the alternative, the geographic specificity of facilities means that geographically there were a number of relevant markets consisting of the overlapping local exchange calling areas within the Seattle/Tacoma

area. I shall refer to either case as the Seattle/Tacoma wireline small business local exchange market.

4. Retail versus Wholesale

Wireline switched local exchange and exchange access services are provided both at wholesale and retail levels. A reseller by definition uses the wholesale services of another provider. Thus, a reseller operates only at the retail level, selling services to end users and purchasing those services from a network provider. A network provider can operate at both the wholesale and retail levels, or only at the wholesale level. During the relevant period, Qwest was a network provider that operated at both the wholesale and retail levels, while MetroNet operated only at the retail level.

Because competition for retail wireline local exchange and exchange access services can occur in the absence of wholesale competition, retail wireline local exchange and exchange access service can be a separate market from wholesale wireline local exchange and exchange access services.

Based on the analysis stated above, I believe the relevant market for the purposes of this case is the Seattle/Tacoma retail wireline small business local exchange and exchange access services market.

III. Market Power

Having determined the relevant market for this case, the second question is whether Qwest had market power in that market. In essence, this requires asking one question and, depending on the answer, it may mean

asking a second question. The first question is whether Qwest was constrained to behave like a firm facing effective competition. If it was or is so constrained, the inquiry is over.

If it is not constrained to behave like a firm facing effective competition, it has market power. In this latter case, the second question is whether the structure of the market would make entry easy. If entry is not easy, Qwest could benefit from the exercise of market power knowing that it would not be constrained any time in the near future by entry into the market by new competitors.

A. The Behavior of a Firm Facing Effective Competition

A firm that faces effective competition has significant constraints on its behavior in that market. Two of these constraints are relevant to this case. The first is that a firm facing effective competition will be unable to charge significantly more than the efficient cost of production of its output. That cost includes a normal level of profit, but not more. The reason for this is simply that, by definition, effective competition means that customers have sufficient alternative sources of supply that too few of them will buy at prices above the minimum efficient cost of supply (including in that cost a normal profit) for the firms that charge more than that price to continue to operate in that market.

The second constraint is that such a firm will be unable to charge different groups of customers different prices for the same output except to the extent that one group of customers costs more to serve than another. Even in this latter case, any price difference will only be able to

reflect the difference in the cost of serving the two different groups of customers, and then only if it is efficient to reflect the cost difference in the price. The reason that this constraint applies in an effectively competitive market is that any firm that tried to charge one set of customers more than another when there was no cost basis for the price difference would find that it was serving only the lower priced customers. Arbitrageurs would appear to buy at the lower price and resell to the customers that the firm would otherwise have sold to at the higher price.

Only if a firm can erect barriers to such resale can it prevent the arbitrage. Only a firm with market power, however, can erect effective barriers to resale. Otherwise, the same arbitrageurs/entrepreneurs would simply turn to an alternative source of supply to serve the customers who would otherwise face higher prices. This in turn would lower the total sales of the firm that tried to charge one group of customers prices significantly above cost. As lower sales would not normally be in the best interest of the firm, it would be forced to abandon its efforts to charge one group of customers a price that varied from the price charged another group of customers without that difference being justified by a difference in cost that is efficient to reflect in prices.

As noted in my introduction, a firm that sets a price for one group of customers that is different from the price for another group of customers when there is no difference in the cost of supplying the two different groups of customers is engaging in price discrimination. Thus, a firm that persistently engages in price discrimination has market power, as it has been able to prevent arbitrage from removing the price discrimination.

Qwest engaged in price discrimination in the prices it charged per line for Centrex features. The cost studies of Qwest show that the cost per line for supplying features do not vary either based on the location of the customer premises to which the lines connect or based on the number of lines supplied to a given customer location. Yet, Qwest charged a different price per line depending upon the number of lines that went to a given customer location. This is price discrimination, and it was price discrimination that has persisted for a number of years. This is clear evidence that Qwest had and continues to have market power in the retail wireline small business local exchange and exchange access services market.

The WUTC also found that Qwest's insistence on charging different prices per line for features based on the number of lines serving a given location was discriminatory. In the Fifteenth Supplemental Order in Docket No. UT-950200, on page 127, it stated:

> Metronet reminds the Commission that it recognized the role of resellers and rebillers in the Centrex Plus case and that the Commission has identified the need to unbundle the NAC [Network Access Channel] from the pricing of the feature package. It urges that this case offers the Commission the opportunity to enforce the parts of the order with which USWC is not now complying. In particular, Metronet contends, USWC should eliminate the location pricing structure that discriminates against resellers and it should unbundle elements of the Centrex Plus service. . . .
>
> The Commission finds that the existing arrangements are discriminatory and in practice they operate to benefit the Company.

Qwest's price discrimination also shows that Qwest has and had market power in the wholesale wireline small business local exchange and exchange access services market as well. Because Qwest has and had a virtual monopoly over facilities that are used to provide retail wireline small business local exchange and exchange access services, resellers could not turn to alternative facilities-based suppliers for services to resell. Thus, the market can not and could not constrain Qwest from engaging in price discrimination in both the wholesale and retail wireline small business local exchange and exchange access services markets.

Moreover, structural factors in telecommunications markets that differ from factors in most other markets indicate that Qwest's monopoly over the wholesale wireline small business local exchange and exchange access services market will persist for some time to come. These structural factors indicate that entry by another firm using its own loop facilities into the Seattle/Tacoma (or any other geographic) retail wireline switched small business local exchange and exchange access services market is not going to occur rapidly, if at all, in the near future. As a result, Qwest's market power in the retail wireline small business local exchange and exchange access services market will also persist for some time to come.

B. Structural Characteristics of Switched Telecommunications Services Creating Market Power for Qwest

There are at least three structural conditions in the wholesale switched local exchange and exchange access services markets that have given and will continue for

some time to give Qwest market power in both the wholesale and retail wireline switched small business local exchange and exchange access services market. These three conditions, or conditions similar to them, do not exist in almost any other markets and make all switched local exchange service markets different from almost all other markets. The first condition is that wireline switched local exchange services markets require that each customer premise be connected to the location from which wireline local exchange service is actually provided by an unbroken physical connection. The second condition is that wireline switched local exchange services markets require direct cooperation among competitors if competition is to be possible at all.

The third condition is the past history of treating switched local exchange services markets as franchised monopolies. Because of this past history, Qwest has physical connections to every location in its past serving territories, and these connections now create a large barrier to entry by another firm. Moreover, again because of the past history of treating switched local exchange services as a franchised monopoly, the need for cooperation is one-way, meaning that entrants need such cooperation from Qwest far more than Qwest needs it from entrants. This gives Qwest enormous market power over new entrants to the extent that legal forces do not or cannot constrain Qwest.

1. The Role of the Loop Network

The first difference between most markets and wireline switched local exchange services markets is that wireline switched local exchange services require a physical

connection that runs unbroken between the location of the customer and the location from which the local exchange carrier supplies the switched local exchange services. This latter location is the location where the wireline local exchange carrier has a switch to which the line serving the customer is connected. The switch connects the line of the customer to all other lines to the other customers served by that switch. The switch also connects the line of the customer to other switches through a trunk, which is a connection between switches. In this way, the customer can reach all other customers who subscribe to switched telecommunications services.

The line serving the customer is called a loop. The customer does not own the loop that serves it. Instead, the company providing service to the customer provides the loop when that customer subscribes to switched local exchange service.

This requirement can be compared to the situation facing a retail provider of paper. The customers of such a retailer must have an unbroken path between their premises and the location of the retail store, but that path is the public (and private) road system provided by neither the retail store (except perhaps for the parking lot at the store) or the customer directly (except perhaps for the customer's driveway and any private road leading to the public road system). Moreover, the public road system is used to connect customer premises with a very large number of different retailers, not just the retailer of paper.

The loop serving a switched local exchange service subscriber, however, leads only to the switch from which that subscriber takes switched local exchange services. That switch may in turn connect the subscriber to other

switches, including switches of other carriers, but those connections cannot be made until the subscriber's loop first interconnects to the switch of the subscriber's provider of switched local exchange service. There are no points along the loop at which the subscriber can "turn" in order to reach a different switched local exchange carrier directly.

2. The Need for Cooperation among Competitors

The second difference between switched local exchange markets and almost all other markets is that firms that compete to provide switched local exchange services cannot do so independently of all other firms in the same market. The reason for this is that the ultimate consumers of switched local exchange services demand that a subscription to switched local exchange service give access to all other subscribers to switched local exchange service, whether in the same or another local exchange area. This demand is not limited to gaining access only to other customers of the same provider of switched local exchange services, but rather to the subscribers of all providers of switched local exchange service.

Because of this requirement to be able to connect to all other subscribers, all firms providing wireline switched telecommunications services using their own facilities must interconnect with at least some other providers of switched telecommunications services. Providers that only supply interexchange ("long distance") switched services ("interexchange carriers") do not need to interconnect with each other, but they must interconnect with all providers of switched local exchange services ("local exchange carriers") in order to carry the calls that originate or

terminate on those exchanges. Competing local exchange carriers with their own facilities, however, must interconnect with each other if more than one such carrier is going to be able to exist at all.

This requirement for cooperation among competitors is not present in almost any other market. A firm selling paper to end user customers does not need direct access to any other firm selling paper to end user customers in the same geographic area. While such a firm does need to be aware of the prices all other firms charge for each kind of paper in order to stay in line with market prices, it otherwise does not need to interact with its competitors. In this sense, firms selling paper to end users operate completely independently of each other. The same cannot be the case for competing retail switched local exchange carriers with their own facilities.

The need for cooperation is not limited, however, to firms that compete to provide wireline switched local exchange services with their own facilities. Firms that provide wireline retail switched local exchange services by means of resale also need cooperation from the underlying wholesale firm that is much more extensive than occurs in normal markets. A reseller of switched local exchange services operates as a competing sales force to the sales force of the firm whose services it is reselling. It needs as much cooperation from the personnel within the wholesale firm who install services, make repairs, and the like as does the wholesale firm's own sales force. This is the case because of how resale of switched local exchange telecommunications services is performed.

A reseller of switched local exchange telecommunications services does not collect those services at its own

premise and then offer them to the public. Instead, such a reseller goes out and persuades customers to take service from it. Once the reseller has a client, it contacts the wholesale carrier and advises it to install the service to be resold at the premise of the end user customer. The reseller may be the initial party that is billed a client, it contacts the wholesale carrier and advises it to install the service to be resold at the premise of the end user customer. The reseller may be the initial party that is billed for the service, but that reseller is not the party that physically installs and maintains the service. Those functions are performed by the wholesale carrier whose services are being resold.

Again, this is in contrast to the situation with the retail sales of paper. A competing retailer can go to a paper wholesaler and get the paper it needs from that firm even if the wholesale firm also sells paper at retail. Once the competing retailer has acquired the paper, the wholesale firm has nothing more to do with the sale of that paper. The only continuing interaction between the wholesaler and the competing retailer is the indirect information flow about the retail price for paper and the direct contact involved when the competing retailer needs more paper.

3. The Role of Past Wireline Switched Local Exchange Service Franchises

A third difference between wireline switched local exchange services markets and almost all other markets is that, in the past, all wireline switched local exchange services markets were treated as franchised monopolies. This means that in every such market there is one firm, the former monopolist or the "incumbent," that previously supplied all of the services to customers within that

geographic region. This position of incumbency gives that firm two advantages that it would not have in wireline switched local exchange markets if all firms were entering the market at the same time. These two advantages are ones, moreover, that differ at least in degree from advantages that incumbent firms have in most other markets. The first is that the facilities of the incumbent create very large barriers to entry, barriers to entry that are larger than those that may exist in most other markets. The second is that the position of incumbency turns the need for cooperation into an enormous source of market power for the incumbent.

a. existing loop plant as a barrier to entry

The incumbent local exchange carrier has ubiquitous facilities reaching geographically every part of the market where subscribers have had premises. This incumbent, moreover, has had perhaps as long as one hundred years to build its network of loops. The exact length of period over which loop plant construction occurred depends upon the time at which the area in question was settled and a franchise granted to a given wireline switched local exchange company. This embedded loop plant of the incumbent creates a massive barrier to entry to other firms that might want to build facilities only for telecommunications except in limited geographic areas where subscriber numbers or telecommunications service volumes are very high.

An entrant that wants to build wireline facilities that will be used only to provide local exchange and exchange access services will only be able to recover its costs and

make a profit (be "commercially successful") if it can garner a sufficient quantity of telecommunications subscribers and/or traffic. To do this, the entrant must first build at least some facilities and then successfully market to end users to overcome customer inertia and habit. The cost of building the facilities will be almost entirely a sunk cost, meaning that it will not be able to be recovered in full if the entrant is unsuccessful in a commercial sense. Moreover, the cost of marketing will also be a sunk cost. The fact that almost all of the costs of entry once incurred will be sunk is itself a barrier to entry.

An entrant that builds facilities in the limited geographic areas that have very high levels of telecommunications traffic ("dense areas") has a much higher chance of being commercially successful than does an entrant who builds in less dense areas. In more dense areas not only is there more potential business, but the cost of the facilities on a per unit basis will be lower than in less dense areas. The unit cost of marketing to overcome inertia may also be lower in more dense areas than in less dense ones. The result of this is that as the telecommunications density of an area falls, the existence of the facilities of the incumbent becomes an ever larger barrier to entry by a competing provider of facilities.

This contrasts with the situation that would exist if there were no incumbent. Under this condition, several firms might construct facilities in a number of areas, all hoping to add sufficient customers to make the construction commercially successful. The costs of marketing, once incurred, would be sunk, which would still create barriers to entry. At least some of the costs of construction, however, would most likely not be sunk, as an entrant that was not successful would likely find a buyer for those

facilities, even if the price were less than the full cost of construction. Thus, in a switched local exchange services market with no incumbent, the height of the barriers to entry created by the fact that some costs, once incurred, would be sunk would be less than the height of the barriers to entry created by the existence of the facilities of the incumbent firm.

Moreover, the height of the barriers to entry into wireline small business switched local exchange service given the facilities of the incumbent is greater than is experienced in other markets with an incumbent firm. To some extent, the existence of an incumbent firm with a long history in a market creates some barrier to entry. Consumer inertia forces an entrant to spend more on marketing than the incumbent needs to spend on a per unit of output basis. The fact that the incumbent has sufficient facilities to serve the whole market makes investment in new facilities more risky than it would otherwise be because the incumbent might choose to ignore some of its past investment as sunk and lower prices to put pressure on the profits that an entrant could expect.

In many other markets that serve end users, however, the barriers to entry caused by the existence of an incumbent firm are often offset by the ability of entrants to offer somewhat diversified products. In many consumer markets, consumer taste is at least somewhat diversified, making it possible for entry to occur with offerings that serve some of that diversity. In wireline switched local exchange service, however, most diversity of customer taste is served by different features provided by the switch rather than by different kinds of loop plant. Thus, the height of the barriers to entry into providing alternative

wireline facilities to all customer premises in a local calling area is greater than is the height of barriers to entry created by incumbency in most other markets.

b. the need for cooperation as a source of market power for the incumbent

As noted earlier, competing providers of switched local exchange services must cooperate with each other for competition to be possible. This cooperation is needed between providers of competing local exchange networks for interconnection and between facilities-based providers and resellers for retail competition to be possible. The need for such cooperation is unlike almost all other markets. Indeed, in most markets, if firms cooperated to the extent necessary in switched local exchange markets, there would be suspicion of collusion.

If all firms providing facilities for switched local exchange service had begun offering those services simultaneously and if it became clear that no one firm could expand its market share at the expense of another firm by refusing to cooperate, all firms would find it in their interests to cooperate. Even if no firms cooperated at the outset, two such firms would soon realize that by cooperating, they could offer their customers expanded calling scope in terms of the number of other parties the customers of those two firms could reach. Over time, all firms would find it in their interests to follow suit.

Because one of the firms in the switched local exchange markets, the incumbent, previously was treated as though it had a franchised monopoly for the whole market, however, the incumbent has no incentive to cooperate. If it does not interconnect with a potential entrant, that firm

cannot enter the market. Even if the incumbent does interconnect, or is forced to interconnect, it can use the form of or price for interconnection to prevent entry altogether or to limit the extent of such entry by a competing provider of facilities. In short, the incumbent has an incentive *not* to interconnect with potential entrants, but potential entrants cannot enter without interconnection. This gives enormous market power to the incumbent switched local exchange provider.

The cumulative effect of the barrier to entry posed by the incumbent's network of loops and the market power conferred on the incumbent by the need for interconnection by a potential entrant that wants to build its own loops means that fewer firms have entered switched local exchange service markets with their own facilities and the geographic reach of those facilities is less than otherwise would be the case. Moreover, future entry will be relatively slow. This means that small business end users will not have substitutes for wireline switched local exchange services for some time to come.

Qwest, as the incumbent firm, still has a very large market share and holds a monopoly over facilities in large geographic portions of the market. This monopoly over facilities will not disappear in the near future. As a result, any firm that wants to compete only at the retail level has no choice but to turn to Qwest for services to resell. This gives Qwest enormous market power in the retail wireline switched small business local exchange market. Moreover, Qwest's market power in this market will continue to exist for a considerable period to come.

IV. Use of Market Power to Retain a Monopoly

Qwest internal documents make clear that it did not like resale of Centrex services. Additionally, its documents also show that it designed the Centrex service tariffs with the intent of stopping resale. This shows that Qwest used its market power in order to maintain a monopoly over the retail wireline switched small business local exchange and exchange access services market.

A. Qwest's Attitude towards Resale of Centrex

Qwest's documents make clear that it did not like resale of its Centrex services. As USW 006972 states:

> Q. Why are you trying to destroy resellers?
>
> A. Resellers have a place when they bring added value to a service. If they add nothing more than what USWC already provides & simply though aggregating customers bring the same services at lower prices then the general body of ratepayers (both residence & business) are hurt.

Qwest labeled resale "arbitrage," which is an activity that takes lower priced offerings and makes them available to consumers who otherwise must buy higher priced offerings. Qwest had two major objections to such resale. The first was the loss of revenue that occurred because the arbitrage undermined Qwest's intended price discrimination in favor only of very large customers. The second was the loss of control over the customer, which in turn led to loss of the ability to sell other services to that customer.

USW 010971-76, dated June 30, 1993, contains an example of Qwest's first objection to the resale of Centrex.[1] On page 010973 it states:

> *5. THE RESALE OF CENTREX TO REPLACE BASIC EXCHANGE SERVICE FOR SMALL BUSINESSES REDUCES REVENUES AND MARGINS.*
> Basic exchange is a highly profitable service for USWC, and one where USWC enjoys a virtual monopoly today. Growth in the small business basic exchange market is 6-8%. Resellers who replace 1FBs with Centrex station lines produce a reduction in both revenues and margins. In addition there is significant evidence that resale activity also results in loss of intraLATA toll and switched access revenues.
>
> *6. CENTREX RESELLERS DO NOT FUNCTION AS AN ALTERNATIVE DISTRIBUTION CHANNEL*
> Traditional marketing theory holds that alternative distribution channels are used to increase sales, improve market coverage, or reduce expense.
>
> Current experience with resellers gives no evidence that there are increased line sales, increased market penetration, or improved market coverage. Resellers target *existing* USWC customers using a "price reduction" sales strategy. Centrex station lines are sold on a one-for-one basis, cannibalizing 1FBs.

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[1] The documents cited in this section of my report are merely illustrative of the points being made, but do not represent all of the possible illustrations of these points.

USW 010991-011038, dated August 24, 1993, makes a similar point. On page 011000, as part of a discussion of "Pure (Centrex) Resale" it states:

> Because SBG [small business] customers are least vulnerable we are creating competition for ourselves, resulting in a net loss of revenue and contribution.

Earlier, Qwest had made the same argument to the WUTC. On November 24, 1992, Qwest filed the rebuttal testimony of Mr. Don Mason in Docket Number UT-911488 et al., USW 051127-50. This testimony on page 14 (USW 051140) states:

> Q. WHY DOES USWC OBJECT TO DESIGNING CENTREX SERVICE TO SIMPLY ENHANCE THE OPPORTUNITIES FOR RESALE TO SMALL, GEOGRAPHICALLY DISPERSED SIMPLE BUSINESS CUSTOMERS?
>
> A. USWC views the resale of improperly designed Centrex services to geographically dispersed customers as simply price arbitrage that results in significant revenue loss to the company.

Qwest did not want to resolve the problem by ending the price discrimination. Sometime in 1995, partly in response to the pending federal legislation that would end franchised monopolies for the larger local exchange companies, Qwest decided it needed to "grandparent" its existing Centrex-type offerings until it could get tariffed a new offering that would be immune to resale. Grandparenting means that a service will continue to be provided to existing customers but not to new ones. USW 023160-023211, undated but circulated sometime around the

beginning of 1996, at page 023163 (on why they were going to grandparent Centron/Centrex):

> Centrex was originally designed to offer cost savings to medium and large business customers in situations where economies of scale and distance from a central office allow lower prices. But recently Centrex had been purchased with increased frequency by other communication companies using US WEST and its customers to subsidize their business costs.
>
> The question that begs asking? With enhanced central office based switched service not due out for nine months, why discontinue the service it is replacing, Centron/Centrex?
>
> The answer is because other communication companies repackage Centrex under their brand names and sell the product as basic business line service. They purchase Centrex at volume discount rates and pass the savings onto their customers. As a result, their basic business line service is usually less than same service provided by U S WEST.
>
> The company is unable to offer similar rates on basic business lines for two reasons. One, regulators require U S WEST to set basic business line prices at a level that ensures an ongoing subsidiary for residential customers. Two, most small business customers neither want nor need multiple lines at numerous locations and, therefore, do not qualify for volume discounts.

Qwest's concern over the effect on it of possible interexchange carrier use of resold Centrex is discussed succinctly in USW 007984-5, titled "Resale & Centrex

Service," which is undated but appears to have been prepared sometime in 1995. On page 007984 it states:

> *Need for Grandparenting?*
> - Expansion of IXC entry play
> - Force facility based vs. resale investments
> - Protect SBG 1FB base

> Eliminate arbitrage

On page 007985 it states:

> Risks total S885M over 5 years, expect SBG to only lose S336M with Centrex Grandparenting

With the passage of the Telecommunications Act of 1996, Qwest also was concerned that resale would make it easier for new firms to enter the various switched local exchange markets. USW 076879-84, undated but written after the passage of the Telecommunications Act of 1996, on page 076879 under the headings, "Types of Centrex Resellers" and "Resale 'Aggregated'" states:

> This type of resale has existed here at U S WEST (USW) well before the Telecommunications Act of 1996 took affect [sic]. In fact, it can be traced back too [sic] as early as the mid 1980s. This application takes an existing USW end user and their associated service offering (usually a 1FL key system) and migrates them into a Centrex Common Block environment. The Common Block becomes the hub (platform) of the resale aggregation. . . . This traditionally has been known as retail resale.
>
> While this application certainly does cause arbitrage to the 1FL revenues of USW it is likely that other USW potential marketing efforts are eroded as well. Ie. long distance, voice messaging, directory advertising and Internet access.

> At this point the patrons service is no longer branded by USW. The products, services and are [sic] now controlled by the reseller. It is easy to understand why some of our resellers today say they are facility-based providers. USW has become their carrier of service. While the reseller may not have built their own switch infrastructure they are leasing ours.
>
> Some reseller's business plans may call for this outsourcing to USW to continue for the long term. Other resellers call for something quite different. I believe that in the near term we have status quo or business as usual. However, in the long term I believe that as mergers continue between telecommunication companies so does the advent of building out their own switches. That is to say, when a reseller acquires their own switch technology and with the advent of long term number portability there is the potential reality of Centrex common blocks being disassembled.

As these quotations show, Qwest did not like resale both because it worked to undermine its price discrimination scheme and because it made competition easier.

Qwest's second objection to the resale of Centrex was that Qwest lost direct contact with the end user customer and this in turn led to loss of more than just some of the revenue from providing switched local exchange service at the higher 1FB rate to that customer. USW 041324-7, dated December 17, 1996, on page 041325 shows this concern:

> Financial considerations aside, the most troubling aspect of customer losses to Centrex resellers is that U S West loses its direct relationship

with those customers, and therefore the opportunity to market additional services and new products that would generate incremental revenues.

B. Design of Centrex Pricing to Prevent Resale

Qwest's price discrimination favored large business users and hurt small business users. Small business users otherwise would largely subscribe to 1FB service, as noted earlier. Qwest knew that the vast majority of subscribers to 1FB service had fewer than 20 lines. USW 006745-54, dated September 25, 1991, states:

> Attached is a brief analysis of the arbitrage potential for Centrex Plus if the minimum line size is lowered from 20 lines to 10 lines. The analysis examines three product lines for arbitrage potential. These are Flat rated business lines, PBX trunks and Centron I.
>
> In summary, we (Dave Teitzel and I) found that there are 242,482 flat business lines in the 10 to 20 line range in the "big five" states. There are 87,592 PBX trunks and 32,582 Centron I lines in the same line size category. These numbers represent approximately 16.1%, 72.9% and 14.8% of the lines in the 1-20 line category for these services respectively. As noted in out [sic] earlier analysis, over 98% of the total lines in the 1FB product reside below the 20 line level

As noted in one of the quotations above, Qwest viewed Centrex resale as "cannibalizing" 1FBs primarily.

Given that the vast majority of customers using 1FB service had less than 20 lines at a given location, it saw it could solve "arbitrage" by altering its Centrex prices to set

the prices for the first 20 lines high enough to make end users indifferent between resold Centrex and 1FB service. USW 008079-84, on page 008084 states:

> *Arbitrage Minimization*
> We do not want to price Centrex, which is a full featured offering – (i.e., access plus switching/ intercom plus features) in such a way that it will displace Basic Exchange service, like 1FBs and Trunks. Centrex was intended as a full service offering, not as inexpensive basic access terminating in Key Systems of PBXs. Consequently, the pricing for small numbers of Centrex lines (less than 50 per location) is set at a level equal to or greater than the price of a 1FB equipped with features. The combination of location specific pricing and relatively high rates for small numbers of station lines combine to make Centrex Plus less attractive than previous Centrex offerings for one traditional set of customers – those with multiple locations served by the same Central Office.

It wanted to do this, however, while maintaining the favorable treatment of larger customers. USW 068547-550, titled "CENTREX PLUS/CENTRON REPOSITIONING KEY OBJECTIVES & RECOMMENDATIONS," undated but with attachments dated between August and October 1997, on page 068547 states:

> *KEY OBJECTIVES*
> ALIGN CURRENT STATION RATES WITH BASIC EXCHANGE (1FB)

MINIMIZE IMPACT ON LARGE CUSTOMERS
(100+ STATIONS)

. . .

RECOMMENDATIONS
INCREASE STATION RATES IN 1 TO
50 RATE STEPS
Centrex Plus – 1 to 20 – 100% increase
21 to 50 – 30% to 50% Increase
51+ - No Increase

An earlier document, USW 041661-95, dated February 1, 1997, is more direct. On page 041674, under the heading "Centrex Prime Issues," it states:

> We have resolved many concerns about Centrex Prime; however, several outstanding issues require resolution and others will need closure in the near future.
>
> Resolved:
> - Resale – Single business restriction, location-based pricing, higher prices.

The discussions above show that Qwest knew that setting high rates for the first 20 lines to a location would end arbitrage. The rates discussed above were rates that bundled together the station line and the features. The same effect could be achieved by setting high rates for the features, which had to be used with a station line. This is the action taken by Qwest.

Based on the analysis above, my preliminary conclusions are that Qwest had market power in the retail wireline switched small business local exchange and exchange access services market in the Seattle/Tacoma

area and that it used that market power to maintain a monopoly in that market during the relevant period of time.

/s/ Nina W. Cornell
Nina W. Cornell

12/04/00
Date

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[ER 00536-00537]

Therefore, we approve the already interim rates for application on an extended interim basis. We instruct the company to present, no later than March 31, 1994, a revised Centrex proposal, including a tariff that clearly identifies pertinent charges for the NAC and for the switching functions provided to Centrex customers, in a manner parallel to tariffs for other commercial services, and including as tariffed items any price listed monopoly bottleneck elements that the Commission has not classified as competitive. The price list should clearly state where in the company's tariffs the rates for associated tariffed services are set out. The price list and tariff together should – as far as practical, yet maintaining pertinent standards of network and service integrity – unbundle the service offerings for Centrex customers.

In preparing this proposal, the company may re-evaluate the tariff proposals now in effect on an interim basis, may decide to propose changes, and may choose to include other tariffed elements. We do not direct the use of a unified line charge, but we direct the company to present parallel offerings, to state clearly why differences are not prohibited by the statutory ban on discrimination and are consistent with tests for imputation, and why the resulting rates are fair, just, reasonable and sufficient. The interim tariffs shall continue until March 31, 1994, and if a filing is made consistent with the terms of this order, until that filing is resolved.

VI. SERVICE RESTRICTION.

We are quite concerned about the company's attempt to limit resale of its services. It proposes to close prior centrex offerings that are available to customers with two to 19 lines. Instead, it would require a 20-line minimum at one location for service under Centrex Plus. The Commission views the 20-line limitation as an attempt to remove those services from the resale marketplace. That is not permissible.

Resale and rebilling[32] are an essential adjunct of free [Page 18] access to, and the growth of competition in, telecommunications service. They bring appropriate market pressures to bear on the underlying provider of resold services, and allow aggregation, combination and coordination of services to supply smaller customers whose needs may be uneconomic for the original supplier to meet.

In Cause No. U-86-86, the company sought competitive classification to compete in the entire business multiline market. It urged competitive classification because it

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[32] Two parties involved in the business of resale and rebilling participated in this proceeding. Enhanced Telemanagement, Inc., (ETI) is in the business of reselling U S WEST'S central office based services and resale of toll service for various long distance carriers such as MCI, Sprint and AT&T, and voice mail service.

MetroNet Services Corporation ("MetroNet") is engaged in the business of telecommunications rebilling, customer service and telecommunications consulting. MetroNet serves as the customer of record for joint user groups involved in the shared use of U S WEST'S centrex-type services. MetroNet places orders with U S WEST for centrex-type lines on behalf of end users in a joint user group, and passes through directly to the end user the pertinent part of U S West's bill.

Resale and rebilling are subject to appropriate restrictions, such as registration, compliance with tariffs, compliance with law, etc.

provided Centrex services only to 13% of the *entire* market, including all customers *with two or more lines.* Now, having won the right to compete for the two to 19-line customer, it defines the market for its Centrex services as only "*large business customers*".

The company's proposed Centrex Plus price list would restrict Centrex Plus against services to customers having fewer than 20 lines at a single premise. Intervenors point out that this will severely restrict opportunities for resale among small business customers. It would bar smaller customers from the service, and would severely restrict resale, without reclassification to redefine the market, and without showing whether that would affect the competitive view of the market for the services.

Under the law, U S WEST may discriminate among customers in a competitive market. But it may not, after classification, without specific Commission approval, use activity in a broadly defined market to secure competitive service classification, then segment the market it is approved to serve and unilaterally eliminate a noncompetitive or less competitive segment from the service. If the company perceives that it has a captive customer base among smaller customers for its tariffed business line services, then reclassification may be proper. Restricting such customers from receiving Centrex services either directly or by resale would be anticompetitive, rather than the response to a competitive market situation.

That is not to say that the company may never restrict its service. It must, however, do so consistently with law and with our approval of the consequences.

Based upon a thorough examination of the record, the Commission concludes that if measures are implemented

to ensure that removal of the 20 lines per location restriction of the

* * *

public interest. Second, we discuss the considerations leading to our chosen course for implementing resale and sharing in light of the parties' comments and why it is preferable to other possibilities, such as a market experiment.

n11 The fundamental statutory definition of the public interest as it relates to communications is given in Section 1 of the Communications Act, where the Commission is directed to "make available, so far as possible . . . a rapid, efficient, Nationwide and worldwide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of the national defense, for the purpose of promoting safety of life and property. . . ."

Lawfulness [**10] of the Tariff Provisions

7. The *Notice* placed the burden of proving these restrictions just and reasonable squarely on the promulgating carrier and, inferentially, on those parties seeking to have these tariff provisions retained. *Notice* at 280; *see also, Resale and Shared Use, 60 FCC 2d at 284-285,* and the cases cited there. Significantly, though, no carrier or other party has attempted in its submissions to defend the lawfulness of tariff restrictions on sharing and resale. There is thus no evidence in the record before us which in any way justifies the restrictions currently in AT&T's tariffs or resale and sharing restrictions in general. Indeed, AT&T itself concedes that resale and sharing of all interstate telecommunications services can have "salutary

effects" (Comments at 1) and that resale and sharing can benefit the public by assuring through the arbitrage mechanism that the resold and shared services are offered at rates closely related to cost. *Id.* at D-7.

8. We do not rely solely on the carrier's or other parties' failure to come forward with justification for these tariff restrictions as the basis for finding them unlawful under Section 201(b) [**11] of the Act. Rather, the record before us permits the affirmative finding that these provisions fail the judicial test established in *Hush-a-Phone Corp. v. U.S., 238 F. 2d 266 (D.C. Cir. 1956) ("Hush-a-Phone")*, to determine if a communications common carriers practice is just and reasonable within the meaning of Section 201(b). There, the court held that AT&T could not by tariff establish a restriction which amounted to "an unwarranted interference with the telephone subscriber's right reasonably to use his telephone in ways which are privately beneficial without being publicly detrimental." *238 F. 2d at 269.* Our past decisions introducing competition into other telecommunications market have rested on this test. It was this principle which guided us in removing the numerous tariff restrictions AT&T established against interconnection of customer-supplied terminal equipment. *See Carterfone, 13 FCC 2d 420 (1968), recon. denied, 14 FCC 2d 605 (1968), recon. 18 FCC 2d 871 (1969).* Our program of registering terminal equipment to ensure private [*172] parties could benefit from its use without any concomitant public detriment was expressly based on *Hush-a-Phone.* [**12] *See* our Decision and Order on Remand in that proceeding, 22 FCC 112 (1957). There we held that tariff restrictions involving interconnection of terminal equipment which encroached upon the right of the user to make reasonable use of AT&T's facilities

without harming them were unlawful. 22 FCC 112, 113-114 (1957); *see Interstate and Foreign MTS and WATS, Docket No. 19528, 35 FCC 2d 533 (1972), 56 FCC 2d 593 (1975), recon. 58 FCC 2d 716 (1976), 58 FCC 2d 736 (1976). aff'd. sub. nom. North cArolina* [sic] *Utilities Commission v. FCC, 552 F. 2d 1036 (D.C. Cir. 1977), cert. denied 434 U.S. 874 (1977).* More recently, we have applied this test in *Resale and Shared Use*, to determine that tariff restrictions which prevented users from reselling or sharing private line services in ways which benefitted [sic] them privately but were not publicly detrimental were unlawful. *See 60 FCC 2d at 280-281.*

9. Applying this test here, we find substantial evidence in the record that a number of public and private benefits may be anticipated to flow from resale and sharing of domestic public switched network services. The comments of potential resellers and sharers persuade us [**13] that the elimination of these restrictions will have a number of salutary public

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